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Renewing America

Print edition January 17th 2009

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Politics this week

Jan 15th 2009
From The Economist print edition

Getty Images

Medical sources in the **Gaza Strip** said that the Palestinian death toll during Israel's military incursion had climbed to over 1,000, including hundreds of children. Amid quickening diplomacy, Israel and Hamas edged closer to accepting an Egyptian-brokered truce. Israel wants an end to rocket fire and arms-smuggling to Gaza. Hamas demands a lifting of Israel's economic blockade. See article

Several bomb blasts in **Baghdad** killed at least eight people. Most of the victims were Iraqi policemen and soldiers, who are increasingly replacing American forces on the streets of the capital.

Corruption charges were reinstated by **South Africa's** supreme court against Jacob Zuma, the leader of the ruling African National Congress, when it decided that a lower court had "overstepped" its authority in striking the charges out. Mr Zuma is the ANC's presidential candidate in elections expected in April, and could thus appear in court as head of state.

Physicians for Human Rights, a campaign group, said that the health crisis and cholera epidemic in **Zimbabwe** are so bad that they should be investigated by the International Criminal Court.

A vote of confidence?

By-elections for 29 seats in **Thailand's** parliament turned out well for the ruling coalition led by the Democrat Party of Abhisit Vejjajiva, the prime minister. His party's candidate also won the contest for the governorship of Bangkok. See article

Amnesty International accused the **Thai army** of "systematic" torture in its war against Muslim separatist insurgents in the south of the country.

A ferry carrying about 250 passengers sank in stormy seas off central **Indonesia**. Scores were missing, feared dead.

Yoshimi Watanabe, a former cabinet minister and senior member of **Japan's** ruling Liberal Democratic Party, quit the party, saying that he feared its leader, Taro Aso, the prime minister, might "invite tragedy" to Japan. Mr Watanabe has been a leading critic of Mr Aso's fiscal policy.

Lasantha Wickrematunge, editor of a **Sri Lankan** newspaper, was shot dead on his way to work. In an article written before his death, he foretold his own murder and implied that it would be the work of the security forces. The army, meanwhile, claimed to have recaptured the whole of the northern Jaffna peninsula from the rebel Liberation Tigers of Tamil Eelam. See article

Pakistan's prime minister, Yousaf Raza Gilani, denied that a dossier handed over by India on last November's attacks in Mumbai constituted "evidence" of Pakistan's involvement. However, Pakistan later said that it had arrested more than 120 people allegedly linked to the attacks.

First in a long line

AP

Mexico's President Felipe Calderón became the first foreign leader to meet Barack Obama since his election victory in November. He said Mr Obama had not proposed renegotiating the North American Free-Trade Agreement but wanted to review labour and environmental standards in the accord.

An earthquake in **Costa Rica** triggered huge landslides, killing 20 people and leaving thousands homeless.

To Italy's dismay, **Brazil's** government asked its courts to grant political asylum to Cesare Battisti, an Italian former leftist activist wanted for four murders in the 1970s.

A freeze in relations

Russia's gas dispute with **Ukraine** sputtered on. The European Union won a promise that Russian gas supplies would resume, only for them to be cut off again; the European Commission spoke of taking legal action. South-east Europe, in particular, continued to feel the chill. See article

In a sign of deteriorating times, anti-government riots took place in Bulgaria and Latvia. Eastern Europe is suffering not only from Russia's gas cut-off but even more from a sudden fall into recession. See article

AP

The **German** government proposed a fiscal stimulus worth €50 billion ($67 billion) over two years. There is also to be a €100 billion fund to guarantee bank loans to business. Germany had been criticised for not doing more to boost its economy; its stimulus is still only 1.3% of annual GDP. Elsewhere in Europe, Greece's credit rating was downgraded, and Ireland, Portugal and Spain were put on notice that theirs might be, too. See article

The British government gave the go-ahead for a third runway at **Heathrow** to the delight of business groups and unions, but causing howls of protests from greens (and London residents who live under the airport's flight path). See article

Goodbye to all that

George Bush held his last press conference as America's president. Mr Bush said there had been disappointments during his tenure, including the prisoner abuse at Abu Ghraib in Iraq and that no WMD were found in that country. In contrast to other jousts with the press corps, he also admitted to "mistakes", such as the "Mission Accomplished" banner in May 2003 that came to symbolise American hubris in Iraq, and his failure to focus sooner on immigration reform.

Barack Obama began drumming up public support for his stimulus package, and also pushed Congress to release funding for the second half of the $700 **bail-out** programme that it agreed to last October. Politicians in both parties want to expand the programme's remit beyond banks.

The Senate began to hold confirmation hearings for Mr Obama's nominees to the new administration. **Hillary Clinton**, who will be secretary of state, sailed through hers in front of the Foreign Relations Committee. See article

Tim Geithner, the incoming treasury secretary, faced a couple of bumps in the Senate over unpaid taxes and an immigrant nanny he once employed. The Finance Committee tried to iron out the bumps and delayed Mr Geithner's hearing until January 21st.

Senate Democrats reversed their position on Roland Burris and decided to let him take the Illinois seat vacated by Mr Obama. Mr Burris was selected to fill the vacancy by **Rod Blagojevich**, Illinois's governor, who is accused of trying to sell the seat. Illinois's House voted to impeach Mr Blagojevich; he is the first governor to face an impeachment trial in 21 years. See article

Business this week

Jan 15th 2009
From The Economist print edition

Citigroup decided to spin off Smith Barney, its broking business, into a joint venture with Morgan Stanley. Citi is expected to offload more assets as it slims down and refocuses on the commercial- and retail-banking divisions that formed its core before its merger with Travelers Group in 1998, when Sandy Weill led the company. The bank has run up billions in net losses during the credit crisis and its share price has plunged over the past two years, to the fury of its investors. See article

Robert Rubin announced his immediate retirement as Citi's special counsel. The former treasury secretary joined the bank in 1999. His resignation letter expressed "great regret" for not recognising "the serious possibility of the extreme circumstances that the financial system faces today".

Deutsche Bank gave warning that it expected to make a loss after taxes in the fourth quarter of €4.8 billion ($6.3 billion), and of €3.9 billion for all of 2008. **Commerzbank**, its local rival, reached agreement recently with the government for more state aid.

Get well soon

Steve Jobs said he would take a leave of absence from Apple until the end of June because his medical condition, a hormone imbalance, is "more complex" than he had thought. His statement came a little over a week after he reassured investors (alarmed at his dramatic weight loss) that he was healthy enough to run the company. The day-to-day management of Apple will pass to its chief operating officer, Tim Cook, who filled in for Mr Jobs in 2004 when he received cancer treatment. See article

Yahoo! named Carol Bartz as its new chief executive. Ms Bartz used to head Autodesk, a software company, and is on the boards of Intel and Cisco Systems. She comes to Yahoo! after a turbulent year for the internet company, during which it resisted a takeover bid from Microsoft and Jerry Yang resigned as chief executive. Microsoft recently said that it is still interested in Yahoo!'s search business. See article

Nortel Networks filed for bankruptcy protection. Based in Toronto, the telecoms-equipment-maker has seen a drop in demand amid the global downturn, as have other technology companies. Its share price has fallen to less than $1 on the New York Stock Exchange. See article

A long road ahead

The **Detroit motor show** was a less glitzy affair than in previous years. Facing the harshest market in decades, carmakers showcased new models fuelled by alternative energy. General Motors, Mercedes-Benz and China's BYD exhibited an assortment of hybrids, plug-ins and pure electric vehicles. Honda laid down a challenge to Toyota's bestselling Prius hybrid—the latest version of which was on display—when it unveiled its cheaper rival, the Insight. See article

Alitalia began operating as a private company, and was boosted by Air France-KLM taking a 25% stake in a "strategic partnership". The troubled Italian airline was saved from oblivion last year when Silvio Berlusconi, Italy's prime minister, pushed for a special bankruptcy law that took on much of the national carrier's debt. Since then, Alitalia has merged with a smaller rival and attracted investors.

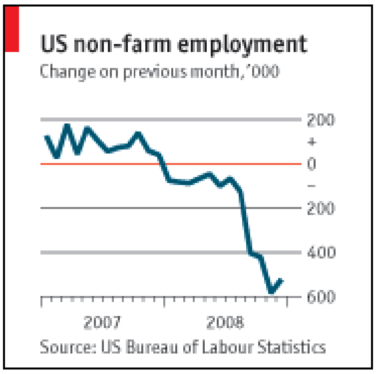
In one of the biggest deals since the beginning of the global financial crisis, **RWE**, a German utility, reached agreement to buy most of **Essent**, a Dutch counterpart, for €8.2 billion ($11 billion).

There was further discomfort for **India's outsourcing industry** when it emerged that the World Bank had banned Wipro Technologies and Megasoft Consultants from its procurement programme because the firms had provided "improper benefits to bank staff". Satyam Computer Services, which was barred from doing business with the bank last year for the same reason, recently revealed a huge accounting fraud.

From the young to the old

Abbott Laboratories, which makes medical devices, agreed to buy **Advanced Medical Optics**, the biggest producer of equipment used in laser-vision surgery, in a deal valued at $2.8 billion. Although the economic downturn is expected to cause the market for laser eye surgery to droop, AMO also specialises in treating cataracts, a condition that is forecast to become more widespread as populations age around the world.

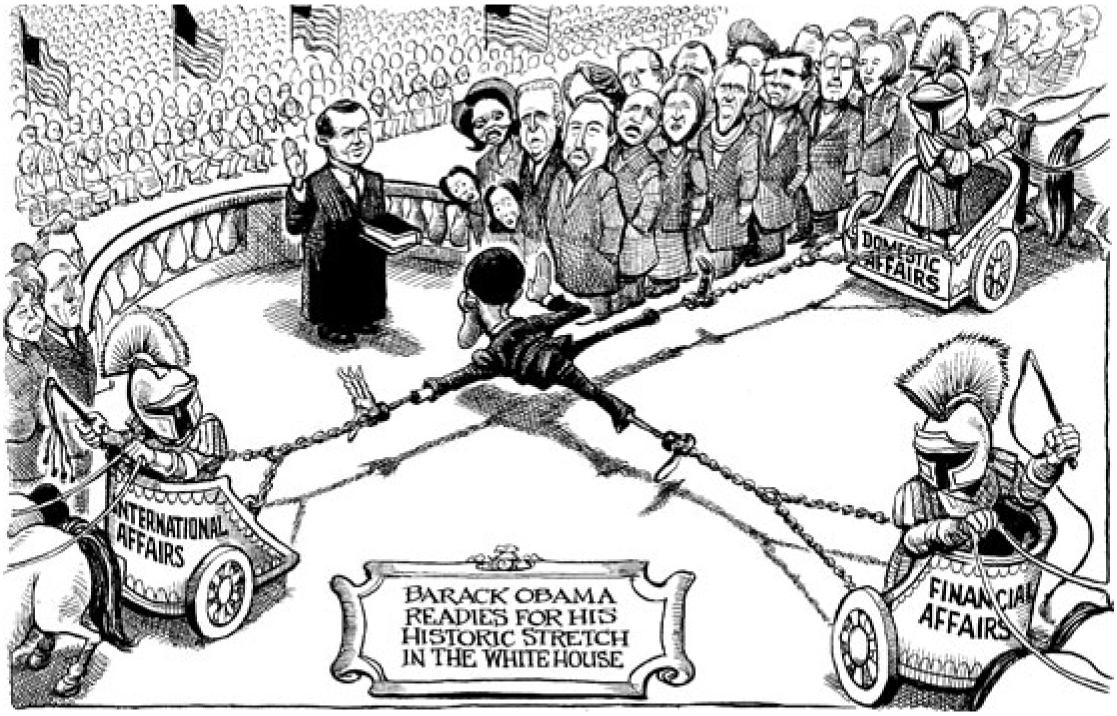
American employers shed more than half a million **jobs** in December, bringing the total number of jobs lost in 2008 to 2.6m, the most since the end of the second world war. The unemployment rate rose to 7.2% for the month. Meanwhile, **retail sales** in December fell by 2.7% from the previous month, the sixth consecutive decline. By some estimates, American stores had their worst holiday shopping season in at least four decades.



KAL's cartoon

Jan 15th 2009
From The Economist print edition

Illustration by KAL



Economist.com OPINION LEADERS

The 44th president

Renewing America

Jan 15th 2009
From The Economist print edition

George Bush has left a dismal legacy, but Barack Obama can do much to repair the damage

CORBIS

SHORTLY after midday on January 20th, Barack Obama will sit for the first time at the desk where the buck stops. The American presidency is always the world's hardest and most consequential job, but it seems particularly so this month. A global recession of a severity not seen for perhaps 80 years; a new war in the Middle East and old ones in Africa; missions very far from accomplished in Iraq and Afghanistan; a prickly Russia and a rising China. These international challenges must jostle for the president's attention alongside noisy domestic concerns like rocketing unemployment, the desperate need for a better health-care system, exploding deficits and failing cities. The burdens, surely, are too many for one man to bear.

Yet neither America nor the world seems to see it that way. A crowd of 2m or more is making its way to Washington, DC, to witness the inauguration of Mr Obama. Billions more will watch it on television. All will do so in a spirit that has been missing for a while—one of optimism. This is not just because a presidency knocked sideways by the events of September 11th 2001, is ending. Next week's inauguration also bears witness to America's awesome power of self-renewal. Because he is young, handsome and intelligent, and also because as the child of a Kansan and a Kenyan he reconciles in his own person one of the world's most hateful divisions, Mr Obama carries with him the hopes of the planet.

Too much so, for sure. But what might the world realistically hope for from Mr Obama's presidency? Many would argue, after the disaster that surrounded George Bush's Iraq adventure, that to rebuild its foreign relationships America must become a more modest giant, more obviously constrained by international law and more committed to working even-handedly for peace in the Middle East and elsewhere. In some ways, that is surely right. Less of Mr Bush's Manichaean arrogance would be welcome.

With us, not withdrawn

This does not mean that America should become more isolationist. Most of the world's biggest problems still cry out for its leadership; and an America that withdraws to heal its domestic wounds will not serve the world well. No one seriously imagines that peace can come to the Middle East without America. Neither Russia, nor China, nor the EU has any appetite to lead efforts to confront nuclear proliferation by Iran or North Korea. Sometimes, as with Kosovo in the 1990s, America needs to act even when the UN hesitates. Above all, America must lead efforts to grapple with the global recession, through its dominant position at the IMF, its vital role in resisting the siren call of protectionism and the stimulative effect of the vast government outlays Mr Obama is planning. Yet a president who understands, as Mr Bush did

not, that America is not the uncontested hyperpower of the 1990s—one who values “soft power” more than the hard version—will be a change for the better. An America led by such a man will listen more carefully to and work more closely with allies and rivals, will strive harder to respect the laws it has signed up to and might enter into new commitments, for instance to tackle climate change.

A renewal of America’s respect for constitution and law would be welcome at home as well as abroad. George the Second disdained the rules of governance established by his forefathers. He wiretapped citizens without authority, secretly permitted the use of torture and dismissed prosecutors on political grounds. Mr Obama seems determined not to follow his example. He has appointed a liberal outsider to run the CIA and a noted academic to head his office of legal counsel. America’s, said one of its founders, should be “a government of laws and not of men”. Under Mr Bush and Dick Cheney, it often seemed the opposite.

But it is the domestic economy which will consume most of Mr Obama’s time. And here American renewal must take two opposite forms. In some ways, the times cry out for more active government: for stronger regulation of banks and near-banks, for much more short-term government spending to counteract the contraction elsewhere in the economy, and for the establishment of a basic health-care system for everyone. But Mr Obama also needs a plan to shrink other aspects of government over the longer term. Without reform of expensive entitlements, the federal government faces bankruptcy. Cutting entitlements at the same time as buying hundreds of billions of dollars-worth of bad loans from Wall Street is difficult politics, to say the least. But at least Mr Obama has acknowledged that he will have to do it. A more equitable health system coupled with a path towards budget reform would, on their own, make Mr Obama’s presidency a remarkable one. And at least he has the votes in Congress to make it happen.

What chance success?

Mr Bush (see article) had a simplistic tendency to see the world through ideological and partisan spectacles. He hung on to bad advisers for longer than he should have; he divided the world too often into good and evil; and he plotted to establish a Republican hegemony although he had sold himself to the electorate as bipartisan. In economic matters, he was too prone to sacrifice the long-term good for short-term gain. He seemed curiously incurious about vital details, such as the conduct of the war in Iraq.

Mr Obama seems to be different. By offering the most prized cabinet job to his rival, Hillary Clinton, and by keeping on Robert Gates, the defence secretary, who has done a good job, Mr Obama has shown a determination not to surround himself with cronies. He has put together a team which has impressed almost everyone with its calibre and its centrism. He has been tough already, dispatching blunderers and being prepared to admit to mistakes. He has repeatedly warned Americans that he will have to do unpleasant things.

The next four, or eight, years may be a disappointment, a triumphant renewal or something in between. Mr Obama is inexperienced, and right now the world looks especially forbidding. But he is a respectful and thoughtful man, and that is a good start.

Sri Lanka

Chronicle of a death foretold

Jan 15th 2009
From The Economist print edition

As the Tamil Tigers face defeat, Sri Lanka's freedoms are also under threat

AFP

THE good that men do is not always interred with their bones. This week saw the publication of a remarkable posthumous column by Lasantha Wickrematunge, a Sri Lankan newspaper editor. He had written it in anticipation of his own murder. That duly came on January 8th, when gunmen on motorcycles shot him on his way to work in the capital, Colombo. He was a brave campaigning journalist. And like too many brave campaigning journalists in Sri Lanka, he is now dead. But at least from the grave he has left an eloquent warning to the government, led by a man he called "friend", President Mahinda Rajapaksa: that as the army grinds relentlessly towards final triumph in a 25-year civil war, the very foundations of the democratic free society it should be fighting for are in jeopardy.

Mr Wickrematunge carried no brief for the enemy, the Liberation Tigers of Tamil Eelam, who have been fighting for an independent homeland for the Tamil minority in the north and east of the country. He rightly described the Tigers as "among the most ruthless and bloodthirsty organisations to have infested the planet". But he railed against both the conduct of the war by the Sri Lankan army and the curtailment of civil liberties even among the Sinhalese majority.

Many journalists have suffered harassment and intimidation. Human-rights groups reckon a dozen have been killed in the past two years. Mr Wickrematunge himself had twice been beaten up and his house had been sprayed with machine-gun fire. Two days before his murder, gunmen with grenades attacked a private television station, which, like Mr Wickrematunge, was accused of being less than wholehearted in its celebration of the army's recent victories.

Mr Wickrematunge predicted that Mr Rajapaksa would be "anguished" by his killing, but would have no choice but to protect the killers. The president has indeed roundly condemned the atrocity. He has suggested it was a plot to deflect attention from the military successes. But journalists find this hard to believe. They know that nobody has been brought to justice for earlier attacks. They suspect that in fact the murder was timed not to distract from military victories but to be drowned in a tide of nationalist enthusiasm. They believe that the security forces must, at the very least, have connived at the brazen attack. Many are understandably scared.

Losing the peace

This is dangerous, leading to a one-sided, triumphalist portrayal of the war. The press has largely been

excluded from the main battlefield in the north. Little is known about the condition of some 250,000 civilians displaced by the fighting. And there is a risk that the dangers of a military victory that is not accompanied by a political settlement will be ignored. If Mr Wickrematunge was indeed killed with the acquiescence of the security forces, this was his crime: to point out that a "victory" which is perceived by a large minority as the subjugation of their rights will be short-lived. "The wounds of war", he wrote in his self-penned obituary "will scar them for ever", leaving "an even more bitter and hateful diaspora".

On the battlefield, the Tigers have nearly lost. Few neutrals can be sad about that. Alarmingly, however, Tiger methods—ruthless silencing of dissenting voices, insistence on fanatical loyalty—seem to be catching on. Spokesmen often justify the government's murky behaviour by reference to the awfulness of the Tigers. But the outside world and Sri Lanka's own citizens have the right to hold a democratically elected government to higher standards than a banned terrorist outfit. That demands a swift and decisive end to the impunity which those who menace and kill the government's critics enjoy.

The Gaza war

Long past time to cease fire

Jan 15th 2009
From The Economist print edition

The war in Gaza has done Israel, as well as the Palestinians, a great deal of damage

Reuters

THE last thing America's new president needs on his first day in the Oval Office is to inherit a vicious war between Israel and the Palestinians in Gaza, filling the world's television screens with images of the terrible suffering inflicted on Arab civilians by America's special friend in the Middle East. But sparing the blushes of Barack Obama is far from the only reason why Israel should end its war without further delay. To push deep into Gaza City with tanks and ground troops, as Israel has threatened in "phase three" of its campaign, will send the already grisly death toll higher still.

Israel's ruthless offensive has already cost it dear in world opinion. The remorseless demolition of wretched homes and lives by a mighty high-tech war machine cannot but cause grief and outrage in any decent onlooker. Israel asks how else it was supposed to respond to the rocket fire directed for years into its farms and cities, but such questions do absolutely nothing to blunt the emotional impact of this sort of war, whose heart-wrenching images are going to widen an already fearful chasm between the Jewish state and the peoples of the region in which it has yet to win acceptance. For its own sake as well as for the sake of the people of Gaza, it must stop.

From a strategic point of view, it anyway has little more to gain by continuing to batter Gaza. If its intention was only to silence Hamas's rockets by re-establishing deterrence, it has surely done so. Its border with Lebanon has been mostly quiet since a Hizbullah raid inside Israel provoked an equally "disproportionate" reaction in 2006. Hamas too will think much harder next time it is tempted to burrow under the border to kidnap Israeli soldiers, or to pop its rockets off at Ashkelon or Beersheba. And though it takes two to cease fire, the outlines of a truce may already be falling into place.

The terms will probably include an end to Hamas's rocket fire and tighter monitoring of the tunnels between Gaza and Egypt, in return for Israel's lifting of its economic blockade (see article). Some Israeli leaders are reported to want to fight on to remove Hamas from power altogether. But that would be utter folly. Loathsome as Hamas's ideology is, a movement of this sort cannot be uprooted by an army. Nor can the rival Fatah party risk returning to Gaza courtesy of Israel's tanks.

After the fighting is over there will also have to be some sort of reckoning. This war has brought a host of charges that Israel has committed war crimes. So far, in a fog thickened by Israel's refusal to allow foreign reporters into Gaza, the evidence is mixed (see article). Such charges need to be investigated independently—and prosecuted if necessary. Israel needs to ask itself some tough questions about the extreme firepower unleashed in congested civilian areas by an army once proud of its "purity of arms".

Israel's critics may have to ask themselves some tough questions too. Lives cannot be weighed and

counted like groceries. But many Jews around the world protest that Israel is being held to a higher standard than the one demanded of many other countries, and to some extent they are right.

Some of the hypocrisy in the Arab world is unspeakable. Syria, for example, is one country to accuse Israel of “genocide”. But in 1982, when Syria’s own Muslim Brotherhood rebelled in the Syrian city of Hama, the regime responded by shelling the city indiscriminately for three weeks, killing about 20,000 or 30,000 civilians. In Gaza Israel has killed 1,000 people. It is not playing by Hama rules, let alone committing genocide. Russia’s onslaught on the Chechen city of Grozny in the mid-1990s is reckoned to have killed some 20,000 civilians. As for Hamas itself, it deliberately murdered hundreds of Israeli civilians in buses and restaurants in the *intifada* of 2001-03.

Do as you would be done by

Of course, people are entitled to expect a Westernised democracy such as Israel to behave better than Syria, Russia or the violent Islamists of Hamas. But they are not entitled to hold Israel to a standard they do not observe themselves. The killing of civilians is a sadly common occurrence in war. American forces are accused of having killed hundreds of civilians when they recaptured the Iraqi city of Fallujah from Islamist insurgents in 2004. American and European air forces have killed thousands of civilians in air raids in Kosovo, Iraq and Afghanistan. So it has been immensely sad, and grotesquely unfair, to watch protesters in London and Paris accusing Israel of behaving as the Nazis did. Just as Israel deserves no special favours when it comes to the prosecution of war crimes, so it should not be singled out while others go unpunished. That will only deepen the misplaced conviction of too many Israelis that a nation in a sea of enemies must in the end survive mainly by the sword.

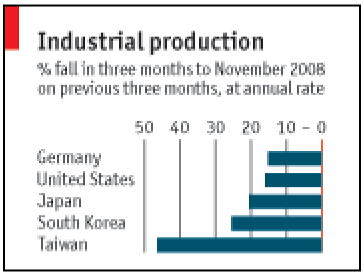
For Israel, however, the sword alone will never be enough. A small country with many foes cannot afford to become a pariah. And Israel has a particular reason to avoid killing civilians, since the people it is bombing are the neighbours with whom it so much needs to live in peace. However justified it believes this war to be, it is a war that has done the cause of peace profound damage. It will take a long time to repair.

World economy

Accelerating downhill

Jan 15th 2009
From The Economist print edition

Why China and Germany need to do more to boost demand



EVERYONE knows that the financial system took a downward dive in mid-September. The failure of Lehman Brothers turned the rich world's credit crunch into a global calamity, as the international banking system came close to collapse and even the most basic functions of finance, such as trade credit, seized up. To stop this financial breakdown sending the world economy into a tailspin, politicians scrambled with bank-rescue packages and promises of fiscal stimulus. Unfortunately, it seems increasingly clear that they failed. Just as the financial crisis went global at the end of 2008, so large chunks of the world economy went into free-fall.

Industry is in grave trouble. Around the world factory output is plunging at its fastest pace in decades as the consequences of slumping demand have rattled along the supply chain. In the three months to November American industrial production fell at an annualised rate of 16% compared with the three months before. Over the same period Japan's fell by 21% and Germany's by 15%. Some emerging economies have done even worse. South Korea's factory output fell at an annualised rate of 25% in the three months to November, about as fast as in its financial crisis a decade ago.

Deep and dark

On the basis of these figures and the gloomy state of manufacturers' order books, economists at JPMorgan reckon that global manufacturing production is likely to have fallen at an annualised rate of almost 20% in the last three months of 2008. The car industry is seeing the most savage drop in sales in its history (see article), but the collapse in demand is widespread. From computer chips to sophisticated machine tools, the production of goods is plunging. As a result trade flows, which had grown faster than output for decades, have recently shifted into reverse. Germany's exports are falling at their fastest pace in many years. Taiwan's exports fell by 42% in the year to December. After years of double-digit growth, China's exports are now falling too, though by less than those in the rest of East Asia (see article).

Manufacturing is highly cyclical, falling first and fast in a downturn. Firms are quick to scale back capital spending and consumers skip new cars rather than scrimp on food or healthcare. A rapid rundown in inventories and temporary distortions in credit markets (see article) have not helped. The collapse of trade finance made it all but impossible for many producers to shift their goods abroad. The plunge in trade flows is partly a result of tumbling commodity prices.

Stumble or slump?

Trade finance is beginning to flow. Firms cannot run down stocks for ever: eventually, they will empty their warehouses. But the damage is done: those temporary factors triggered a collapse in global demand that has now spread way beyond the Anglo-Saxon economies at the heart of the credit crisis.

Output in the euro area probably fell as fast as in Britain and America in the last three months of 2008, even as Japan's GDP sagged still more dramatically (see article). The drop in industrial output has hammered export-dependent economies, from Germany to Taiwan, and there is little sign that domestic demand in these countries is stepping in to compensate. In some countries with big external surpluses, notably China, the opposite may be true. China's imports have been falling faster than its exports and in recent months its trade surplus has risen.

Add these factors together and the outlook seems grim. This sharp global drop in industrial production

will itself lead to more weakness, as unemployment rises around the world and demand therefore falls. And in America, too, the outlook has grown darker. Around three-quarters of output growth over the past two years came from net exports. That prop will go. And while domestic demand in surplus economies flags, the imbalances that have contributed to the current crisis will not right themselves, and will encourage protectionism. When rich-country economies were growing, China's surplus was a political lightning-rod; how much more dangerous will it be when unemployment is rising?

To mitigate these risks policymakers need to do more to prop up demand, especially in countries that have external surpluses. Fiscal stimulus packages that seemed sufficient two months ago may be too small, and too slow to take effect. Much of the infrastructure spending in the package that China announced in November will not kick in until later this year. This week's decision by Germany's government to add a second €50 billion ($66 billion) stimulus package is a step forward, though at barely more than 1% of GDP it is still far too small (see article). For the time being, the biggest and quickest fiscal boost is likely to come from America, as the Obama team seeks speedy passage of an $800 billion package of tax cuts and spending. That sort of money may put a brake on the global industrial collapse, but it will not set the world economy on course for a sustainable recovery. Others still need to do far more.

Britain's credit-guarantee plan

Buddy, can you insure a loan?

Jan 15th 2009
From The Economist print edition

The scheme will help, but more fundamental remedies are needed

Illustration by David Simonds

BRITAIN'S interest rates, at least those set by the central bank, are now at record lows. The price of credit is irrelevant, however, if almost none is made available. As long as banks restrict lending while they strive to mend overstretched balance-sheets the economy will continue to wilt. New figures suggest that British GDP may have shrunk by 1.5% in the final quarter of 2008, compared with the previous three months.

Businesses are in especially dire straits. The supply of new lending to companies dried up in the second half of last year. Not before time, the government is taking steps to get credit flowing again (see article). Lord Mandelson, the business secretary, announced on January 14th that the state would partially guarantee up to £20 billion ($29 billion) of loans to small and medium-sized enterprises (those with turnovers up to an annual £500m). In return for a fee, the taxpayer will in effect carry half of the possible losses on the lending. And, since the guarantee will free some bank capital, part of the deal is that bankers lend additional money to companies, too.

Britain is not the only country where businesses are struggling to find finance. Germany's €100 billion ($133 billion) loan-guarantee scheme is an attempt to spur stalled bank lending; in America, though central-bank purchases of commercial paper are starting to work, there are renewed calls for more state help to boost lending. Is Britain's approach the right one?

In normal times governments rightly try to avoid insuring bank credit. Taxpayers bear many risks but credit risk is one best left to bankers, however ineptly they may have dealt with it in the recent past. When politicians and their officials start deciding who should and who should not get loans, the allocation of credit tends to be decided by who lobbies most effectively rather than by where the money should go. Taxpayers end up footing the bill for dud loans and the economy underperforms as the flow of finance is misdirected.

But these are not normal times. Britain's new scheme avoids the trap of politicised lending by leaving specific credit decisions with the banks. They will present a pool of eligible loans to the government, which will insure them as overall portfolios. The plan has other things going for it too. Because banks will do the heavy lifting, the credit pump can be reprimed swiftly. The decision to focus the help on smaller firms is sensible because they are more reliant on bank finance than bigger ones. And taxpayers' risk is reduced because the guaranteed short-term lending is financing not untried new projects but working capital to keep businesses ticking over.

One worry about the scheme is that it is too small to make much difference, given that outstanding

lending to private (non-financial) companies in Britain is around £500 billion. A plan already proposed by the Conservative opposition—to which the government's bears more than a passing resemblance—envisaged guaranteeing loans of £50 billion. Business leaders and Tories complain that ministers have set their sights too low. But this objection looks premature, since the government says it will introduce additional help for bigger firms.

A more fundamental concern is that, even extended to larger companies, credit guarantees will prove no more than a stopgap. That's what banking crises are all about. More and more loans turn sour as asset prices fall and businesses fail; that in turn saps banks' capital, forcing further credit contraction. Guarantee schemes may help to mitigate this process, but they will not reverse it. Two more remedies will be needed.

More taxpayer support, alas

One is to provide even more capital to the banks. The emergency recapitalisations of last autumn staved off the wholesale collapse of financial systems. But, as the recession intensifies and more loans turn bad, more capital is likely to be needed.

The second, highlighted by Ben Bernanke, the chairman of America's central bank, on a visit to London this week, is to draw the poison of the toxic assets on banks' balance-sheets (see article). This, of course, was the original purpose of America's $700 billion bail-out plan for its banks through the Troubled Asset Relief Programme (TARP) before this approach was trumped by recapitalisation. Yet the lesson from previous banking crises, notably in Sweden (which acted swiftly in the early 1990s) and Japan (which dragged its feet) is that clearing out bad loans, for example through a "bad bank", is vital to get the credit system working again.

One way or another taxpayers will have to provide more support to still-wobbly banks, in order for them to support credit-crunched businesses. This extension of government involvement may be necessary but only as the least bad of some awful options. In particular, the danger is that inefficient firms that deserve to go to the wall will get bailed out along with viable ones—impeding the normal creative destruction of capitalism. And taxpayers face losses—lots and lots of them. That is the unwelcome price of sorting out a banking crisis.

Technology in the recession

Less is Moore

Jan 15th 2009
From The Economist print edition

There is strong demand for technologies that do the same for less money, rather than more for the same price

Illustration by David Simonds

FOR years, the computer industry has made steady progress by following Moore's law, derived from an observation made in 1965 by Gordon Moore, a co-founder of Intel, now the world's biggest chipmaker. His original formulation was rather technical, and was based on the number of transistors that could be crammed onto a chip, but it was adopted as a road map by the industry, so that it became a self-fulfilling prophecy. In practice, it boils down to the following: the cost of a given amount of computing power falls by half roughly every 18 months; so the amount of computing power available at a particular price doubles over the same period.

This has resulted in a geometric increase in the processing power of desktop computers, laptops, mobile phones, and so forth. Constant improvements mean that more features can be added to these products each year without increasing the price. A desire to do ever more elaborate things with computers—in particular, to supply and consume growing volumes of information over the internet—kept people and companies upgrading. Each time they bought a new machine, it cost around the same as the previous one, but did a lot more. But now things are changing, partly because the industry is maturing, and partly because of the recession. Suddenly there is much more interest in products that apply the flip side of Moore's law: instead of providing ever-increasing performance at a particular price, they provide a particular level of performance at an ever-lower price.

The most visible manifestation of this trend is the rise of the netbook, or small, low-cost laptop. Netbooks are great for browsing the web on the sofa, or tapping out a report on the plane. They will not run the latest games, and by modern standards have limited storage capacity and processing power. They are, in short, comparable to laptops from two or three years ago. But they are cheap, costing as little as £150 in Britain and $250 in America, and they are flying off the shelves: sales of netbooks increased from 182,000 in 2007 to 11m in 2008, and will reach 21m this year, according to IDC, a market-research firm. For common tasks, such as checking e-mail and shopping online, they are good enough.

Many companies, it seems, would also prefer computers to get cheaper rather than more powerful. The recession is hurting the computer industry, albeit not as badly as the bursting of the dotcom bubble did in 2000-01 (see article), but those companies that enable their customers to benefit from the flip side of Moore's law, and do the same for less, will be best-placed to ride out the storm. A good example of this is virtualisation: using software to divide up a single server computer so that it can do the work of several, and is cheaper to run. The more powerful that machine, the more computers it can replace and the less, in effect, each "virtual" machine costs.

The rise of “good enough” computing

The “good enough” approach also works with software. Supplying “software as a service”, via the web, as done by Salesforce.com, NetSuite and Google, among others, usually means sacrificing the bells and whistles that are offered by conventional software. Google Docs lacks the fancy features of Microsoft Word, for example. But hardly anyone uses all those features anyway, and Google Docs is free. Once again, many users are happy to eschew higher performance in order to save money. Even Microsoft has cottoned on: the next version of Windows is intended to do the same as the last version, Vista, but to run faster and use fewer resources. If so, it will be the first version of Windows that makes computers run faster than the previous version. That could be bad news for computer-makers, since users will be less inclined to upgrade. But they are less inclined to do so already. Moore’s law has not been repealed, but more people are taking the dividend it provides in cash, rather than processor cycles.

On music, the Arab-Israeli conflict, William James, risk, shopping, Generation Y

Jan 15th 2009
From The Economist print edition

Ode to joy

SIR – I appreciated your article on human evolution and music ("Why music?", December 20th). However, I am a composer and none of the theories you posited helped explain my evolutionary development. I do not compose symphonies to get the girl. (I did play guitar songs to woo the girl in my teens, but with very limited success.) Indeed, you missed the vital reason why humans create and listen to music: joy.

Your suggestion that "little else would change" if music "vanished from the species" assumes no tangible loss of joy, which is relevant to human activity. Joy is both a perception of and response to beauty. We perceive beauty in all manner of diversity: a sunrise, a trout flashing in a stream, the grand impression of a 1965 Mustang in cherry condition; and we create beauty in ten thousand ways, all of which are important. Like visual art and dance, music remains an expression of human thought, separate from, and perhaps deeper than, our written or spoken languages.

Beauty must surely be essential to our lives and our evolution, even though the perception and creation of beauty are two abilities in human evolution that have nothing to do with sex, or social clans, or "cheesecake".

Charles Roland Berry
Seattle

SIR – The idea that musical ability increases the chances of a male to attract mates is a typical example of science confusing correlation with causality. The male musicians usually cited by scientists to support that notion are invariably those who make large amounts of money and acquire great fame, such as Jimi Hendrix in your article.

However, for every Hendrix there are thousands of musicians of equal or even better musical ability who have not succeeded in converting their musicality into wealth and reputation. If the mating hypothesis were correct, most of these musicians would still be successful sexually. I would stake my violin that they are not.

Torsten Sommer
Nuremberg, Germany

SIR – According to you, "singing is auditory masturbation" and playing a musical instrument is "pornography". Then I must assume that since I've been playing a musical instrument while accompanying opera singers onstage for 46 years, I am not only a pornographer but perhaps the most notorious voyeur in the history of music.

Les Dreyer
Retired violinist of the Metropolitan Opera orchestra
New York

Compare and contrast

SIR – Your leader on the wider Arab-Israeli conflict stated that since the 1948 war "many of the refugees have been stuck…in a sad finger of dunes, the Gaza Strip, pointing at the bright lights of Tel Aviv" ("The hundred years' war", January 10th). But the thriving Tel Aviv metropolis was itself a collection of sand dunes once, and this raises an important difference between Israeli and Arab approaches to the conflict.

In the 20 years between partition and the six-day war in 1967, the Palestinians, Egyptians and Jordanians made no effort to build a Palestinian state in Gaza or the West Bank. And in the three years since Israel's unilateral withdrawal from Gaza in 2005, the Palestinians have again squandered an opportunity to start building a state with bright lights, instead focusing on weapons and striking Israel.

If the Palestinians and wider Arab world decided to put the development of their own societies ahead of tearing down Israel the conflict would resolve itself quite quickly. Israel cannot be expected to cure the Arabs of this illness.

Edieal Pinker
Associate professor of computers and information systems
University of Rochester
Rochester, New York

SIR – The solution to Israeli security lies not in military might but in providing the people of Gaza and the West Bank with hope and opportunity. Not so long ago a small piece of land on the edge of a continent was at war, torn by religious and cultural differences, with its two peoples disputing the ownership of the land that both claimed as rightfully theirs. Today Northern Ireland is at (relative) peace. In the end neither British military might nor Irish Republican insurgency was victorious. Instead, the solution, when it came, was mundane: the promise of a stable economy and jobs.

Aidan McKeown
London

To "L" and back

SIR – You attribute to William James the phrase "a bloomin' buzzin' confusion" (Lexington, January 3rd). In the same issue, in an article about numbers, you render James's words less folksily as "blooming, buzzing confusion" ("Easy as 1, 2, 3"). No doubt most of your readers who have hitherto come across the phrase think it should read "booming buzzing confusion", but your version is correct.

The text in James's "The Principles of Psychology" indeed reads "blooming buzzing confusion". I think, however, logic and context jointly suggest that "blooming" in the original text is a typographical error for "booming", and that those who get it wrong therefore get it right.

A.C. Grayling
Professor of philosophy
Birkbeck, University of London
London

Risk analysis

SIR – It is surprising to me that Marcel Rohner, the boss of UBS, apparently believes that to "buy a share and sell a call option on that same share" would mean "your balance-sheet has grown but your risk has not" ("Return to wealth", January 3rd). On the contrary, betting on a share price going up and selling a call option on that share will most definitely increase your risk. If the share price goes to zero, your loss on your share position will be its full purchase price, mitigated only by the necessarily smaller premium you received for writing the call.

Nicholas MacCabe
Zurich

Supermarket sweep

SIR – I read your article on the science of shopping ("The way the brain buys", December 20th). As stores will soon no longer need checkouts to scan my items and charge my card accordingly, why can't they simply do my shopping? Why bother thinking for ourselves when stores know what we want, what we should want and when we want it? Why not just deliver it to us?

Ann Gallagher
Bethesda, Maryland

No net gains for Net Geners

SIR – You advised "Generation Y" workers, who were born in the 1980s and 1990s, to "take the world as it is, not as they would like it to be" ("Managing the Facebookers", January 3rd). When I was planning my career every article I read about the future of employment said that I would have to become a multilingual renaissance man, happy to fly anywhere in the world at a moment's notice, with no job security or employee loyalty. Unless I focused my energies on "brand me" I would be obsolete in a world of technophile jet-setters.

Perhaps instead of revelling in our hubris, today's managers could apologise for the destruction of the job market for which we so eagerly prepared. I'm on sabbatical for two months, so please could you post any apologies on my Facebook wall.

Peter Main
London

George Bush's legacy

The frat boy ships out

Jan 15th 2009
From The Economist print edition

AP

Few people will mourn the departure of the 43rd president

HE LEAVES the White House as one of the least popular and most divisive presidents in American history. At home, his approval rating has been stuck in the 20s for months; abroad, George Bush has presided over the most catastrophic collapse in America's reputation since the second world war. The American economy is in deep recession, brought on by a crisis that forced Mr Bush to preside over huge and unpopular bail-outs.

America is embroiled in two wars, one of which Mr Bush launched against the tide of world opinion. The Bush family name, once among the most illustrious in American political life, is now so tainted that Jeb, George's younger brother, recently decided not to run for the Senate from Florida. A Bush relative describes family gatherings as "funeral wakes".

Few people would have predicted this litany of disasters when Mr Bush ran for the presidency in 2000. True, the 2000 election was likely to be divisive because of the peculiar arithmetic of the outcome (Mr Bush lost the popular vote to Al Gore by 500,000 votes, then won a disputed recount in Florida by a few hundred). But for most people Mr Bush was a pretty acceptable choice, and certainly not a crusader-in-waiting.

He came across as an affable chap, particularly when compared with his uptight rival. Frank Bruni, who covered his election campaign for the *New York Times*, wrote in 2002 that "the Bush I knew was part scamp and part bumbler, a timeless fraternity boy and heedless cutup, a weekday gym rat and weekend napster." And the then governor of Texas presented himself as a centrist—a new kind of "compassionate conservative", a "uniter rather than a divider", an advocate of a "humble" and restrained foreign policy. *The Economist* liked this mixture enough to endorse him in 2000.

How did all this change? How did the uniter become a divider? How did Mr Bush's governing style shape American politics over the next eight years? And what legacy has the 43rd president left for the 44th?

His supporters—the few that remain—point out that this was a presidency knocked sideways by the terrorist attacks of September 11th 2001, which no one foresaw. The huge expansion of government and executive power under Mr Bush, and the prosecution of a disastrous war, all unrolled in the wake of those attacks. The financial crisis, which began with overvalued homes and sloppily underwritten mortgages, was the product of numerous forces and failures in which Mr Bush was not a major contributor; they included low interest rates, bankers' reckless risk-taking, flawed regulation and

consumers' bubble mentality, all of which spanned borders.

Yet Mr Bush's presidency was also poisoned by his own ambition. Mr Bruni's "timeless fraternity boy" wanted to be a great president. He not only wanted to win the second term that Bill Clinton had denied to his father—though that mattered to him enormously. He also wanted to usher in a period of prolonged Republican hegemony, much as William McKinley had done for his party in the late 19th century. After the September 11th attacks he not only itched to destroy al-Qaeda and the Taliban. He also wanted to tackle the root causes of terrorism in the Middle East. Mr Bush frequently spoke about how much he hated anything that was "small ball". His close advisers repeatedly described him as a "transformative president".

Mr Bush's role model throughout his presidency was not his father but the patron saint of the modern conservative movement, Ronald Reagan. He regarded Reagan as a man who had unleashed free-enterprise and defeated the Soviet Empire, and he tried to do the same with his huge tax cuts and his global war on terror. He mimicked Reagan's Western style, even relaxing on a Texas ranch where Reagan had taken his holidays on a Californian one; and he echoed Reagan's enthusiastic use of the word "evil".

Other facets of Mr Bush's personality mixed with his vaulting ambition to undermine his presidency. Mr Bush is what the British call an inverted snob. A scion of one of America's most powerful families, he is a devotee of sunbelt populism; a product of Yale and Harvard Business School, he is a scourge of eggheads. Mr Bush is a convert to an evangelical Christianity that emphasises emotion—particularly the intensely emotional experience of being born again—over ratiocination. He also styled himself, much like Reagan, as a decider rather than a details man; many people who met him were astonished by what they described as his "lack of inquisitiveness" and his general "passivity".

This led Mr Bush to distrust the Washington establishment, and even to believe that establishment wisdom was probably wrong simply by virtue of what it was. Fred Barnes, a conservative journalist, entitled his book on Mr Bush "Rebel in Chief". He quotes one Bush confidante as saying: "One tux a term. That's our idea of outreach to the Washington community."

Lack of curiosity also led Mr Bush to suspect intellectuals in general and academic experts in particular. David Frum, who wrote speeches for Mr Bush during his first term, noted that "conspicuous intelligence seemed actively unwelcome in the Bush White House". The Bush cabinet was "solid and reliable", but contained no "really high-powered brains". Karen Hughes, one of his closest advisers, "rarely read books and distrusted people who did". Ron Suskind, a journalist, has argued that Mr Bush created a "faith-based presidency" in which decisions, precisely because they were based on faith, could not be revised subsequently.

For the good of the party

Mr Bush relied heavily on a small inner core of advisers. The most important of these was Dick Cheney, who quickly became the most powerful vice-president in American history. Mr Cheney used his mastery of bureaucracy to fill the administration with his protégés and to control the flow of information to the president. He pushed Mr Bush forcefully to the right on everything from global warming to the invasion of Iraq; he also fought ruthlessly to expand the power of the executive branch, which he thought had been dangerously restricted since Watergate.

The two other decisive figures were Karl Rove, Mr Bush's longtime political guru, and Donald Rumsfeld, his defence secretary. Mr Rove was obsessed by pursuing his dream of a rolling Republican realignment, subordinating everything to party politics. Mr Rumsfeld regarded the Iraq war not, like his boss, as an exercise in democracy-building, but as an opportunity to test the model of an "agile military" that he was pioneering at the Pentagon.

The fruit of all this can be seen in the three most notable characteristics of the Bush presidency: partisanship, politicisation and incompetence. Mr Bush was the most partisan president in living memory. He was content to be president of half the country—a leader who fused his roles of head of state and leader of his party. He devoted his presidency to feeding the Republican coalition that elected him.

The most important legislation of his first year in office was a $1.35 trillion tax cut that handed an extra $53,000 to the top 1% of earners. At his farewell press conference on January 12th Mr Bush called his tax cuts the "right course of action", as if they were an unpopular but heroic decision. They weren't. The budget was in surplus in 2000, and both Mr Bush's main Republican rival, John McCain, and his

Democratic opponent, Mr Gore, also wanted to cut taxes, but by less, so as to pay down more debt and shore up Social Security (public pensions). Mr Bush's much larger tax cut reflected his, and his party's, belief that lower taxes restrain the size of government, empower individuals and are good for both growth and Republican prospects.

Mr Bush sold his first tax cut, in 2001, as recession insurance. He did the same in 2003; and though the budget surplus was gone by then, he upped the ante by also lowering taxes on capital gains and dividends. Lower taxes on capital boost investment, but, as one former senior administration official says, that thought was secondary: "It was a political winner that happened to coincide with good economics." Lower taxes on capital had the potential to bolster a growing "investor class" that tended to vote Republican.

AP

Cheney, the string-puller

Relentless partisanship led to the politicisation of almost everything Mr Bush did. He used his first televised address to justify putting strict limits on federal funding for stem-cell research, and used the first veto of his presidency to prevent the expansion of that funding. He appointed two "strict constructionist" judges to the Supreme Court, John Roberts and Samuel Alito, turned his back on the Kyoto protocol, dismissed several international treaties, particularly the anti-ballistic-missile treaty, loosened regulations on firearms and campaigned against gay marriage. His energy policy was written by Mr Cheney with the help of a handful of cronies from the energy industry. His lacklustre attorney-general Alberto Gonzales, who was forced to resign in disgrace, was only the most visible of an army of over-promoted, ideologically vetted homunculi.

Bumbling towards Baghdad

The Iraq war was a case study of what happens when politicisation is mixed with incompetence. A long-standing convention holds that politics stops at the ocean's edge. But Mr Bush and his inner circle labelled the Democrats "Defeaticrats" whenever they were reluctant to support extending the war from Afghanistan to Iraq. They manipulated intelligence to demonstrate that Saddam Hussein possessed weapons of mass destruction and had close relations with al-Qaeda. This not only divided a country that had been brought together by September 11th; it also undermined popular support for what Mr Bush regarded as the central theme of his presidency, the war on terror.

Sean Wilentz, a historian at Princeton, remarks how unusual it is for a president to have politicised such a national catastrophe: "No other president—Lincoln in the civil war, FDR in world war two, John F. Kennedy at critical moments of the cold war—faced with such a monumental set of military and political circumstances, failed to embrace the opposing political party to help wage a truly national struggle. But Bush shut out and even demonised the Democrats."

The invasion of Iraq was like much else in the Bush years—an initial triumph that contained the seeds of disaster. Thomas Ricks, the author of "Fiasco", argues that "the US-led invasion was launched recklessly, with a flawed plan for war and a worse approach to occupation." Mr Rumsfeld's decision to invade with too few troops led inexorably to the breakdown of law and order, which turned the Iraqi population against the Americans, and to the Abu Ghraib scandal, which solidified world opinion against America. But Mr Bush responded to the unfolding disaster with a mixture of denial and stubbornness, refusing to force Mr Rumsfeld to adjust his plans. He engaged in an absurd photo-op to declare "Mission accomplished", and he also gave medals to three of the architects of the debacle, George Tenet, Tommy Franks and Paul Bremer.

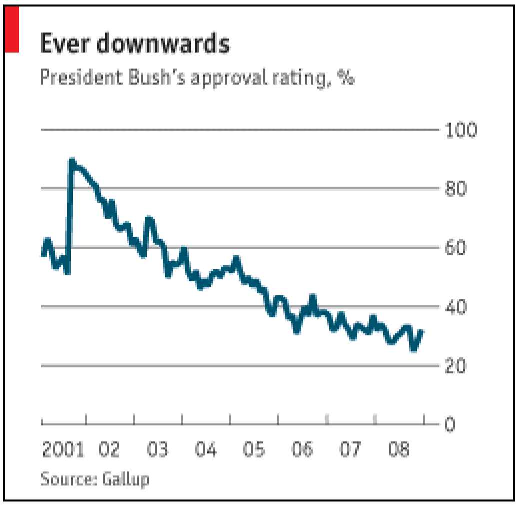
Mr Bush's weaknesses were on display again in the second great disaster of his administration, Hurricane Katrina, which struck New Orleans in August 2005. The hurricane exposed Mr Bush's congenital passivity: he did not visit New Orleans until five days later, after first viewing the damage from the safety of Air Force One. It also exposed the consequences of filling your administration with third-rate hacks. The head of the Federal Emergency Management Agency, Michael Brown, a former commissioner for the International Arabian Horse Association, made a hash of dealing with the disaster but nevertheless received an encomium from the president—"Brownie, you're doing a heckuva job"—that rang around the country.

The Truman hope

How will Mr Bush be judged in the light of history? "Many historians", says Princeton's Mr Wilentz, "are now wondering whether Bush, in fact, will be remembered as the very worst president in all of American history." A humbled Mr Bush counters his critics by pointing out that "You never know what your history is going to be like until long after you're gone." He frequently invokes the name of Harry Truman as a president who was dismissed at the time, but is now regarded as one of the greats.

Mr Bush's presidency is not without its merits. He supported sensible immigration reform. He proposed tighter regulation of Fannie Mae and Freddie Mac, the now-nationalised mortagage agencies. Congress stymied him on both points. He promoted more members of minorities than any previous president; and he also stood up to the Dixiecrat wing of his party, edging Trent Lott, a Mississippi senator, out of his job as majority leader for segregation-favouring remarks. He maintained good relations with India, Japan and, particularly, Africa, where he launched a $15 billion anti-AIDS programme.

On trade, too, Mr Bush's heart was in the right place, though policy was at first subverted by political or strategic priorities. In 2002 he approved tariffs on imported steel to fulfil a promise Mr Cheney made to steelworkers in West Virginia, a state crucial to his 2000 election. That year he also signed a massive increase in farm subsidies so as not to antagonise farm-state congressmen facing election that autumn. But these early protectionist impulses gave way to a more stalwart defence of trade. Mr Bush resisted intense pressure from Congress to punish China for keeping its currency low. After Congress narrowly granted him streamlined authority to negotiate treaties, he pushed the Doha global free-trade agreement and a free-trade area of the Americas. These efforts failed in part because of other countries' intransigence, notably India's in the case of the Doha round. In the absence of a broader framework, his administration pursued bilateral trade deals, although often with countries chosen for strategic rather than economic value: Oman and Bahrain, for example, which host American military bases.



His administration's handling of the financial crisis alternated between shaky and competent. Swallowing his visceral scorn for finance, Mr Bush delegated crisis management to Henry Paulson, his treasury secretary and a former investment banker. Mr Paulson's remedies were often blunted by complexity, inconsistency and his insistence that lenders and borrowers pay for their mistakes. His decision to let Lehman Brothers fail significantly intensified the crisis. Still, Mr Paulson regrouped by pouring hundreds of billions of government dollars into the tottering financial system, which has bought a measure of stability. Mr Bush backed this, in violation of his own anti-interventionist impulses.

Mr Bush showed more ability to learn from his mistakes than his critics realise or than he himself might like to admit. The second Bush administration was very different from the first. He reached out to America's allies, particularly through his second secretary of state, Condoleezza Rice, establishing good relations with France's Nicolas Sarkozy and Germany's Angela Merkel; and he also improved his administration's profile in the world by firing Donald Rumsfeld and sidelining various neoconservatives.

The president's legendary stubbornness paid off in one area: his decision to ignore Washington's wise men and increase troop levels in Iraq, rather than preparing for withdrawal, probably averted disaster there and certainly increased stability. There is even a possibility that Mr Bush's most controversial decision may eventually be vindicated: if Iraq turns into a beacon of democracy in the Middle East, then he will look much better in a decade's time than he does today. But that is a big "if".

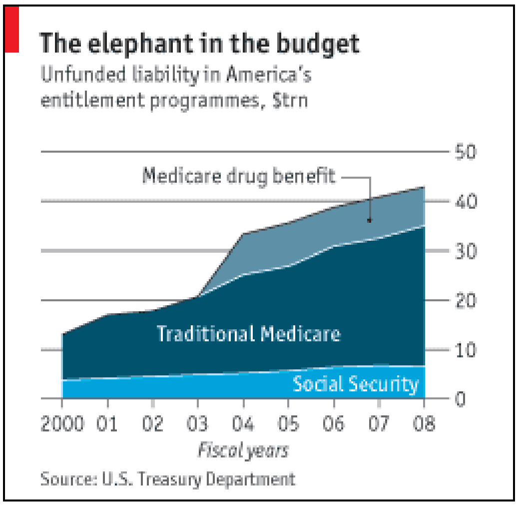
Farewell to restraint

Meanwhile, his policy of cutting taxes while increasing spending—of simultaneously pursuing big government and small government—dramatically swelled the deficit. He inherited a projected ten-year surplus of $5.6 trillion and bequeaths a ten-year deficit of $6 trillion, assuming his tax cuts remain in place. Hardly the makings of a positive judgment from future historians.

In pursuit of his fiscal ambitions, Mr Bush helped roll over or sweep aside long-standing rules and conventions designed to keep the deficit in check. Republicans in Congress pushed through his 2001 and 2003 tax cuts under a parliamentary manoeuvre called "reconciliation" previously reserved for measures that reduced, or did not increase, the deficit. Doing so largely stripped Democrats of their ability to raise procedural obstacles in the Senate, but also required the tax cuts to expire after ten years. As the projected surpluses melted away, Mr Bush cut the horizon in his budgets from ten years to five, masking the long-term impact of his policies.

For years the president refused to include the cost of the Afghanistan and Iraq wars in his budget. He also acquiesced in the expiry of 12-year-old budget rules that made it difficult to cut taxes or increase spending if it raised the deficit. In coming years deficit reduction will be hard enough, with the recession-induced collapse in tax collections and the cost of the bail-outs. Jim Horney, a former Democratic congressional staffer now at the liberal Centre on Budget and Policy Priorities, a think-tank, says it has been made even harder by the disappearance of any culture of restraint in Congress.

Mr Bush's biggest failure, however, is on entitlements. The ageing of the population, coupled with rapidly rising health-care costs, means that in coming decades Social Security and Medicare benefits will outstrip workers' payroll contributions by trillions of dollars. Both programmes presented Mr Bush with a political opportunity. To pry elderly voters away from the Democrats, he promised to add a prescription-drug benefit as part of any Medicare reform. He did so in 2003, winning the support of the AARP, the powerful pensioners' lobby, which has long been seen as closer to the Democrats. But in the end he achieved few cost savings, while adding a staggering $8 trillion to Medicare's unfunded liability (see chart).



Social Security, founded in the Depression to provide workers with a secure pension, has defied all recent attempts to make it solvent. Although such an attempt was part of Mr Bush's first election campaign, it was not solvency that animated him, but the prospect of workers diverting some of their Social Security contributions to private investment accounts. Such accounts were intended as the centrepiece of the Republican Party's "ownership society".

Economists are divided on the merit of such accounts, but agree they do nothing to restore solvency: that requires slimmer benefits, higher taxes, or both. Because of the political peril of touching Social Security, broad reform demands bipartisan support. Yet David Walker, the federal government's chief auditor from 1998 to 2008, says Mr Bush doomed his own effort, launched after his 2004 re-election, by seeking to shape its outcome from the start. He had appointed an advisory commission whose members first had to agree to support private accounts (which many Democrats oppose). He issued detailed proposals for private accounts while eschewing, until much later, solvency proposals. His administration staged some 200 "town hall" events attended by pre-screened participants, Mr Walker says, yet at the end of it all support for Mr Bush's proposal was lower than when it began.

Between the Medicare drug benefit and the failure to restore solvency to Social Security, the long-term unfunded cost of America's programmes for the elderly had last year reached a stratospheric $43 trillion, or 5% of future wages, compared with $13 trillion, or 3% of future wages, in 2000. Mr Obama and Congress may still be able to mend entitlements. But they start with a bigger and more imminent danger than Mr Bush did eight years ago, and one made even harder by the deep hole the current recession has created in the budget.

The costs of ambition

The neoconservatives who had such influence over Mr Bush argued that unintended consequences were usually more important than the intended ones. The Bush presidency has proved them right in this, if in little else.

A president who laboured to produce Republican hegemony ended up dramatically weakening the Republican Party. The Democratic Party is now in a more powerful position than it has been at any time since the second world war. In the Senate, the Democrats have a majority of 59 seats to 41 (including two independents who caucus with the Democrats); in the House, they hold 256 seats to the

Republicans' 178. Americans who came of age during the Bush years identify with the Democrats by the largest majority recorded for any age cohort since the second world war.

A president who believed that America's global supremacy was guaranteed by America's unrivalled military power ended up demonstrating the limits of both. Many of America's closest allies in Europe refused to co-operate with the Iraq war. Many of America's rivals used America's travails in Iraq to extend their power: Iran is more powerful than it was in 2000, and closer to acquiring a nuclear bomb; Russia and China have extended their web of alliances and strengthened their regional influence. Mr Bush's recalibration of his policies in his second term suggests that even he recognises that America's loss of soft power has cost it dear.

The American military machine is under intense strain. The demands of tackling the Iraq insurgency have forced America to short-change Afghanistan. Deployments have grown longer and redeployments more frequent. Recruitment standards are going down. The neoconservative dream of a muscle-bound America knocking down the "axis of evil" and planting democracies from North Korea to Iran looks, more than ever, like an overheated fantasy cooked up in a think-tank.

Finally, Mr Bush also demonstrated the limits of capitalist triumphalism. The Bush administration was as business-friendly as any in American history: Mr Bush was the first president with an MBA (from Harvard) and he appointed four CEOs to his cabinet, more than any previous president. The administration was also wedded to the fundamental tenets of Reaganomics: cut taxes and free the supply side and everything else will take care of itself. Mr Cheney even argued explicitly that "Reagan taught us that deficits don't matter."

Mr Bush now leaves behind a tax system in some ways less efficient than the one he inherited, in need of annual patches, and unable to fund the government even in good times. He also leaves behind a broken budget process. Any economic triumphalism is long gone. Many of the CEOs, most notably Donald Rumsfeld and Paul O'Neill, proved to be dismal administrators. Reaganomics helped to produce a giant deficit. The financial crisis has made re-regulation rather than deregulation the mantra in Washington, while government has acquired a much bigger role in the economy through its backing of banks and car companies.

EPA

Next!

"I inherited a recession, I'm ending on a recession," he noted at his press conference on January 12th. He wasn't asking for pity, only to be judged on what happened in between. Unfortunately, that economic legacy is littered with wasted opportunity, bad judgments and politicised policy. The budget surplus he inherited is now a deficit, the fiscal hole in America's retiree programmes is bigger than ever, the tax system is an unstable, patched-up mess.

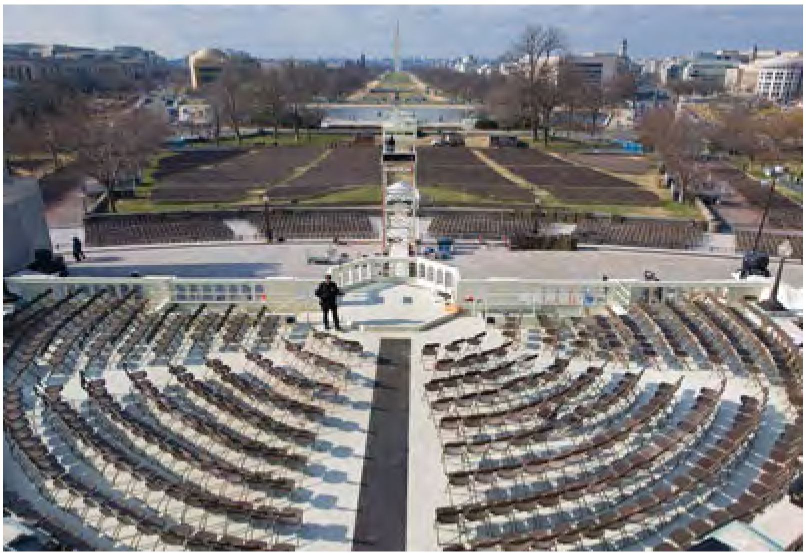
It is not all his fault. But for the most part, good policy repeatedly took a back seat to Mr Bush's overweening political ambition. Both the country and, ultimately, the Republican Party are left the worse for it.

The transition

Ready for Day One

Jan 15th 2009 | WASHINGTON, DC
From The Economist print edition

AFP



Preparations for the handover have gone rather well

SUBWAY tickets in Washington, DC, used to boast a cuddly picture of the pandas in the zoo. Now they have a smiling picture of Barack Obama instead. With the inauguration only days away, there is no escaping the festive mood. Babies are wearing "Time for a change" outfits. Tat merchants are selling ghastly Barack Obama plates and repulsive handbags honouring his wife. The president-elect himself has issued posters exhorting his fans to "Be the change". But behind all the schlock-peddling and platitude-spouting, the transition has been going rather well.

That is not, of course, a reliable guide to the future. This time eight years ago people were gushing about how efficient and businesslike the incoming Bush administration was. After all the dithering and lying and dodgy ethics and comely interns of the Clinton years, Americans found the new president's decisiveness, punctuality, uncomplicated marriage and early bedtimes refreshing. Before he was sworn in, Mr Bush's approval rating was nearly as high as Mr Obama's is now. It has slipped a bit since then.

Still, Mr Obama has named his team quickly. Nearly all the top people—cabinet secretaries and senior White House aides—are now chosen, and Senate confirmation hearings are well under way. Mr Bush was also quick to pick his top people, but slower to make his second-tier appointments, notes Linda Fowler, a political scientist at Dartmouth College. His health secretary, for example, was confirmed quickly but had no deputy to carry out his orders.

Mr Bush struggled in part because he feared, with some justification, that the permanent bureaucracy in Washington would be hostile to a Republican agenda. He searched long and hard for loyal Republicans for nearly every post, sometimes sacrificing talent in the process. Mr Obama does not have this problem. Nearly everyone in Washington voted for him. So he worries less about loyalty and more about ability. He did not pick Hillary Clinton as his secretary of state because of her lifelong devotion to the Obama cause.

On paper, the new administration looks formidable. Tim Geithner, the incoming treasury secretary, helped the Bush administration's efforts to bail out the financial sector, so he will not have to cram for his new job. He stumbled this week, however: it emerged that he failed to pay $34,000 in taxes between 2001 and 2004. But this may have been an innocent mistake, and senators are keen to have someone competent handling the financial crisis, so he will probably get away with it.

Meanwhile, Mr Obama is lobbying Congress to release the second half of a $700 billion package (the

Troubled Assets Relief Programme) aimed at shoring up the financial sector. One of his top economic advisers, Larry Summers, sent a letter to congressional leaders agreeing that the plan so far had been insufficiently transparent, too soft on bankers and not helpful enough to homeowners facing foreclosure. He promised to correct this. Because of the way the package is structured, Congress can deny Mr Obama the funds, but Mr Obama can veto their denial. He would rather get the money without an unseemly quarrel with his own party, however.

Team Obama

Name	Age	Proposed job	Previous job	Comment
Hillary Clinton	61	Secretary of state	Senator for New York	Obama's bitter rival for the Democratic nomination brought into the tent
Tim Geithner	47	Treasury secretary	Head of the New York Fed	Earned plaudits for his handling of Wall Street's meltdown
Robert Gates	65	Defence secretary	Defence secretary	Successfully implemented the Iraq "surge" policy
Eric Holder	57	Attorney-general	Lawyer	A key ally, but under fire for his role in pardoning Marc Rich in the Clinton administration
Tom Daschle	61	Secretary for health and human services	Lawyer	Former Senate majority leader, in a good position to spearhead health reform
Larry Summers	54	Head of National Economic Council	Academic economist	Noted centrist appointed to co-ordinate economic recovery policy
Rahm Emanuel	49	White House chief of staff	Congressman	Not an Obama loyalist, but a tough cookie who knows both Congress and the administration
David Axelrod	53	Senior adviser	Political strategist	Obama's Karl Rove

Mr Obama's choice of Mrs Clinton to head the State Department suggests either that he wants to delegate the day-to-day handling of foreign affairs to a star, or that he wants someone to blame if something goes horribly wrong. Both could be true. Mrs Clinton has never run a big organisation (the State Department has 57,000 employees) and she made a hash of running a medium-sized one (her presidential campaign). But she works hard, masters her briefing books and has few serious policy differences with Mr Obama. Despite the gazillions her husband has raised for his foundation from iffy foreigners, she looked set to breeze through her confirmation hearings this week (see article).

Mr Obama's decision to keep George Bush's defence secretary, Robert Gates, was as bold as it was sensible. The anti-war left are appalled. But Mr Obama knows his time will be gobbled up by the financial crisis. He needs someone who requires no preparation to handle two wars and an army under terrible strain. Mr Gates will oversee a steady withdrawal of troops from Iraq and a surge into Afghanistan. Some day, budget permitting, he will expand America's armed forces. Mr Obama thinks he can trust Mr Gates because he is a professional, not a politician. Asked in 2006 whether America was winning in Iraq, he replied: "No, sir." That things look better now is partly thanks to him.

Despite the financial crisis, Mr Obama is determined to extend health insurance to nearly everyone. His health tsar, Tom Daschle, is steeped in the subject. In a recent book, he advocated much more government involvement in health care. He understands how politically hard this will be. As a senator, he had a ringside seat when the Clintons' overweening health-care project was knocked down in the 1990s. But as the top Democrat in the Senate between 1994 and 2004, he has clout on Capitol Hill. He is surrounded by able wonks, and he has Mr Obama's ear. Public opinion is in his favour, at least for now. But every nook of America's insanely complex health-care system has entrenched defenders, and every previous attempt to provide universal health care has failed.

So far, only minor hiccups have afflicted the transition. The biggest concerned Bill Richardson, Mr Obama's choice for commerce secretary. Mr Richardson, who is governor of New Mexico, had to withdraw his nomination after it became apparent that a probe into his administration's alleged influence-peddling was serious. Mr Obama looked clueless for not having vetted Mr Richardson properly, but the story was quickly forgotten, much like Mr Richardson's run for president last year.

Reuters

See you in the Oval

Controversy dogs Mr Obama's choice for attorney-general, too. Eric Holder has been chided for his role in Bill Clinton's pardon of a dodgy financier and grant of clemency for some Puerto Rican terrorists. But most senators think he would be an improvement on Alberto Gonzales. The governor of Illinois's alleged attempt to sell Mr Obama's old Senate seat has also proved embarrassing, but reasonable people can hardly blame Mr Obama for that.

Some of the new cabinet are attracting flak for their beliefs. Lawmakers from coal-mining states shudder at the view of Steven Chu, the incoming energy secretary, that carbon-belching coal is his "worst nightmare". Carol Browner, the new climate tsar, delights greens but worries those who would rather environmental regulations did not cost too much. The *Washington Times*, a conservative paper, plays up her ties to the Socialist International, which sounds scary but is a respectable umbrella group that includes Britain's Labour Party.

The rest of the team raises few hackles. Janet Napolitano, the governor of Arizona, is a solid choice for secretary of homeland security. As the chief executive of a state with a long and porous border with Mexico, she has a feel for well-policed frontiers. And Arne Duncan, a cautious school reformer from Chicago, makes an uncontroversial pick for education secretary.

Mr Obama's team includes an unusually high number of ex-senators: Mrs Clinton, Mr Daschle, Ken Salazar, the interior secretary, Vice-President Joe Biden and, of course, the president himself. It is well-supplied with brainpower: Mr Chu has a Nobel prize for physics, and Mr Summers was president of Harvard. And it has several tall people who share Mr Obama's love of basketball. It includes few southerners or Republicans, however. The only Republican of note is the transport secretary, Ray LaHood.

One thing to thank Mr Bush for

The outgoing president has done an admirable job of smoothing the transition. Mr Bush's staff have done all they can to brief and assist the new people, for example by quickly giving 1,000 members of the Obama team clearance to look at sensitive information. Mindful that terrorists like to strike when their enemies are unprepared, incoming and outgoing aides and cabinet members met at the White House this week to rehearse their response to a hypothetical terrorist attack. The Bushites' co-operativeness contrasts with the childish behaviour of some Clintonites in 2001, who vandalised White House offices as they packed up to leave.

The challenges Mr Obama faces are too large to tackle without Republican support. So far, he has made a good show of bipartisanship, both in small ways (dining this week with conservative columnists) and in larger ones (putting big tax cuts in his stimulus proposals). He has shown flexibility in dealing with Congress, too. For example, when lawmakers pointed out that a plan to offer handouts to firms that create jobs was open to abuse—sly firms could sack 100 people, hire ten and claim a handout for creating jobs—Mr Obama ditched the idea.

Because any president's ability to push laws through Congress depends in large measure on his personal popularity, Mr Obama is in a strong position. He is much more popular than Congress or his own party. And he has three strategies for staying that way. First, obviously, to govern well. Second, to use his eloquence to persuade Americans that what he is doing is right. And third, to keep courting and raising money from the online network of supporters who helped him get elected.

Permanent campaigns do not always work, however. The activists who loved Mr Obama when he

promised vaguely-defined “change” may love him less when he has to make hard choices. And the power of the bully pulpit is often overestimated. Mr Obama will be judged by his results, just as Mr Bush has been.

Preparing for the inauguration

Huddled masses

Jan 15th 2009 | WASHINGTON, DC
From The Economist print edition

But fewer than first forecast

SINCE November 5th Washington has been bracing for an invasion of zealous Obamaites eager to see their man take the oath of office. Congressmen with only a couple of hundred tickets to hand out have been swamped with thousands of requests each. The city has furiously concocted crowd-control measures and warned residents that going downtown on inauguration day will be nearly impossible. Driving will be a wasted effort: the city centre will be filled with tour buses on the streets that are open, and many won't be. Neither will the bridges crossing the Potomac river, which connect the District of Columbia to its suburbs in Virginia.

But something happened as would-be visitors were refused tickets and word of vast, unruly crowds got out: interest waned a bit. First estimates of how many would flock to the capital ranged as high as 5m. Now the city reckons as "few" as 2m might show up. That still means a doubling of Washington's usual daytime population, and all of them will be jammed into the monument-heavy core of the city. But it is only 800,000 more than the record 1.2m that showed up for Lyndon Johnson's inauguration in 1965. And many of those may stay away, if the weather is as freezing as forecast. Pennsylvania's Red Lion bus company cancelled all its inauguration-week trips into Washington as its passengers backed out.

For city officials this is a relief. Not, though, for local entrepreneurs. Aiming to avoid the crowds and make some money in the process, Washingtonians planned holidays for inauguration week and put their flats and houses up for rent. The city government temporarily suspended rent controls to smooth the process, prompting residents to ask $10,000 or more for the use of their homes. But supply has vastly outstripped demand; only 5% of properties listed on inauguralhomes.com have been let so far, its founder reports, and prime real estate is going for only around $500 a night. Would-be landlords are slashing their prices and hawking their homes on Craigslist.

Meanwhile, those unable to make the pilgrimage might attend the next-best thing. MSNBC, a cable news channel, and Screenvision, an advertising firm, are showing the inauguration in 27 cinemas around the country. And there's always the television.

Hillary Clinton at State

Not necessarily a team of rivals

Jan 15th 2009 | WASHINGTON, DC
From The Economist print edition

Barack Obama might actually get on well with his new chief diplomat

AP

UNLESS an unexpected meltdown occurs, Hillary Clinton will be America's next secretary of state. On January 13th the former first lady testified before the Senate Foreign Relations Committee, now chaired by another failed presidential candidate, John Kerry. Democrats and Republicans fell over each other to offer her congratulations. Speculation that Mrs Clinton's approval might be held up because dodgy non-Americans had donated to her husband's foundation did not materialise. "A speck" on her record, said Bob Corker, Republican of Tennessee.

Now the question is what kind of relationship Mrs Clinton will have with Barack Obama. Her legacy, and Mr Obama's ability to prosecute effective foreign policy, will depend on the answer.

Associates of Mrs Clinton say that she has forgone any ambitions for higher office, preferring to make her tenure as America's chief diplomat the pinnacle of her career. Accordingly, she placed conditions on her acceptance of the job: that she would have direct access to Mr Obama whenever she pleased, and that she would be able to bring in her own staff.

Since then, Mrs Clinton has made it clear she wants to beef up the State Department, first by appointing two deputies rather than one as is usual. James Steinberg, a deputy national security adviser when Bill Clinton was president, will look after policy, and Jacob Lew, once Mr Clinton's budget chief, will see to management—and, presumably, obtaining and spending more money. Mrs Clinton also plans to bring back a hallmark of the Clinton years: a series of special envoys to cover certain international hot zones. Some names have leaked out. Richard Holbrooke, the pugnacious career diplomat who brokered the Dayton peace accords in the Balkans, will probably get the Pakistan-Afghanistan portfolio. Dennis Ross, another former diplomat from the Clinton years, will probably take Iran. It is still not at all clear who, if anyone, will get the toughest job, the Israel-Palestine assignment.

Is Foggy Bottom becoming a nest of Clintonistas? Not really: the staff profile differs little from the rest of the incoming administration, which is littered with former Clintonites who have come over to Mr Obama. As well as having worked for Mr Clinton, Mr Steinberg and Mr Ross are both confidants of the president-elect.

And Mr Obama and Mrs Clinton might even turn out to get on famously. He wants a stronger State Department to take a more active role in applying "soft power". She will be a tireless advocate for her agency, if only to buff up her legacy. Aaron David Miller, a scholar at Washington's Woodrow Wilson International Centre and a former Middle East negotiator, argues that Mrs Clinton has little incentive to cause ructions between herself and "no drama" Obama. Any visible daylight between the two and she would speedily become irrelevant in the eyes of foreign leaders.

That may not stop tensions from developing, however, especially if Mr Obama makes decisions that Mrs Clinton dislikes. She will be under less compulsion to remain loyal than other secretaries of state—not least because she can be sure that Mr Obama would have an extremely hard time firing her.

Adult literacy

The Readers

Jan 15th 2009
From The Economist print edition

Evidence that dumbing down is not inevitable

Illustration by Claudio Munoz

FOR a quarter of a century, surveys of reading habits by the National Endowment for the Arts (NEA), a federally-funded body, have been favourite material for anyone who thinks America is dumbing down. Susan Jacoby, author of "The Age of American Unreason", for example, cites the 2007 NEA report that "the proportion of 17-year-olds who read nothing (unless required to do so for school) more than doubled between 1984 and 2004."

So it is a surprise that this bellwether seems to have taken a turn for the better. This week the NEA reported that, for the first time since 1982 when its survey began, the number of adults who said they had read a novel, short story, poem or play in the past 12 months had gone up, rising from 47% of the population in 2002 to over 50% in 2008.*

The increase, modest as it is, has thrown educationalists into a tizzy. "It's just a blip," one professor told the *New York Times*. It is certainly a snapshot. But it is not statistically insignificant. As the NEA's research director, Sunil Iyengar, points out, almost every demographic and ethnic group seems to be reading more.

The increase has been most marked in groups whose reading had declined most in the past 25 years, African-Americans and Hispanics (up by 15% and 20% respectively since 2002). It has also been larger among people at lower levels of education: reading among college graduates was flat, but among those who dropped out of high school it rose from under a quarter to over a third.

Most remarkable of all has been the rebound among young men. The numbers of men aged 18-24 who say they are reading books (not just online) rose 24% in 2002-08. Teachers sometimes despair of young men, whose educational performance has lagged behind that of young women almost across the board. But the reading gap at least may be narrowing.

Dana Gioia, the NEA's outgoing chairman, thinks the reason for the turnaround is the public reaction to earlier reports which had sounded the alarm. "There has been a measurable change in society's commitment to literacy," he says. "Reading has become a higher priority."

It may also be benefiting from the growing popularity of serious-minded leisure pursuits of many kinds. Museums, literary festivals and live opera transmissions into cinemas are all reporting larger audiences. Mr Iyengar thinks the division between those who read a lot and those who don't is eroding. What has not changed, though, is America's "functional illiteracy" rate. Fully 21% of adult Americans did not read a book last year because they couldn't, one of the worst rates in the rich world.

* Reading on the Rise. Available at http://www.arts.gov/research/ReadingonRise.pdf

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UNITED STATES

The Rod Blagojevich saga

The second act

Jan 15th 2009 | CHICAGO
From The Economist print edition

All the world's a stage for Illinois's mop-haired governor

ROD BLAGOJEVICH has, if nothing else, a flair for the dramatic. On January 9th, hours after the Illinois House had impeached him, the governor summoned Tennyson. "Strong in will", he recited at a press conference, "To strive, to seek, to find, and not to yield." The governor's own compositions, according to a criminal complaint, have been rather less poetic.

AP

Hair today, where tomorrow?

Theatrics have overrun Illinois since December 9th, when a federal prosecutor laid charges that Mr Blagojevich had, *inter alia*, plotted to sell Barack Obama's vacant Senate seat. While Democratic leaders fretted over finding Mr Obama's successor, the governor simply appointed Roland Burris; and though the appointment sparked outrage at first, this week the Senate embraced Mr Burris as one of its own.

The drama in Illinois, however, will continue for some time. Mr Blagojevich's impeachment will lead to a trial in the state Senate. Proceedings will not start until January 26th and may drag on for weeks.

Amazingly, in a state known for sleaze, Mr Blagojevich is the first governor of Illinois to be impeached. Only seven American governors have ever been so canned, though 1920s Oklahoma saw two deploy the National Guard in an effort to deter opponents. Mr Blagojevich is unlikely to use such tactics, but he remains defiant. His impeachment, he says, is mere political manoeuvring. Indeed, he has yet to be indicted.

Illinois's legislators, however, say they are not holding a criminal trial. They are merely judging whether the governor abused his power. The 13 points of impeachment include not only charges related to December's criminal complaint, but also acts such as the governor's unauthorised expansion of state health care.

On the morning of his impeachment, Mr Blagojevich cheerfully jogged past the cameramen who had staked out his home. As he dominates the spotlight, Illinois itself is languishing. The state has a deficit of more than $2 billion. A recovery plan is "stuck in the mud", according to Pat Quinn, the lieutenant-governor who would replace Mr Blagojevich if he went. Alexi Giannoulias, Illinois's treasurer, laments that Moody's, a rating agency, has recently downgraded the state's bond rating. "The government", says Mr Quinn wearily, "is in paralysis under Rod Blagojevich." Despite such statements, the governor is preparing his budget address for next month. "From our side it's proceeding as normal," says Lucio Guerrero, his spokesman. "I can't speak for the other elected officials who are choosing not to work with us."

In Minnesota, meanwhile, another Senate kerfuffle slowly continues. A recount gave Al Franken, a former

comedian, 225 more votes than Norm Coleman, the Republican incumbent. Mr Coleman is taking the battle to court. Unfortunately for the people of Minnesota and Illinois, these could both be five-acters.

New wilderness

Where the wild things are

Jan 15th 2009 | LOS ANGELES
From The Economist print edition

An ambitious push to put more land out of reach of man

FEW groups have prayed more fervently for George Bush's departure than conservationists. As he leaves, they are preparing to consecrate new ground. On January 11th the Senate voted to advance a bill that would designate almost 2m acres (800,000 hectares) of land as wilderness. If put together, the parcels of land would be one and a half times as big as the Grand Canyon National Park. It would be the biggest expansion of wilderness for 15 years.

The protected areas would be subject to much greater restrictions even than America's national parks. A 1964 act defines wilderness, rather poetically, as "an area where the earth and its community of life are untrammelled by man". You can walk, ride a horse and often hunt in wilderness. You cannot normally drill for oil, cut down a tree, build a road or drive anything more powerful than an electric wheelchair.

Many of the designated areas are in the path of rapid development—or were before the slumping housing market and the credit crunch stalled new building. More than 190,000 acres would be put off limits in Riverside and San Bernardino Counties in southern California, which together added 800,000 residents between 2000 and 2007. Similarly explosive growth occurred on the outskirts of Boise in Idaho, along Colorado's front range and in southwest Utah. All will get large new wilderness areas (see map).

It might appear that conservation groups are chancing it by trying to secure the toughest level of protection for lands in some of the country's fastest-growing places. But they have learned two things from their time in the political wilderness.

The first is the importance of building broad coalitions. Unable to find support in Washington, conservationists in many states have spent the past few years forming alliances with hunters and even ranchers. They have cut deals with local politicians—a few hundred thousand acres of wilderness in return for the speedy sale of a few thousand acres for development.

These alliances are paying off. Many of the dozens of local measures that comprise the Senate lands bill enjoy support from conservative Western Republicans. The bill's fiercest opponents in the Senate represent Oklahoma and South Carolina—states that would hardly be affected by it. As a result, its political chances are fair.

The other lesson conservationists have learned is that the federal government cannot be trusted. Paul Spitler of the Wilderness Society says that the steady encroachment of logging and drilling on federal land leaves them with no choice but to seek the toughest measures: “If we’ve learned anything from eight years of the Bush administration, it’s that lesser protection leaves land vulnerable.”

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Parties

Dancing in the downturn

Jan 15th 2009 | HOUSTON
From The Economist print edition

The American tradition of debutante balls rages strong

SILK gowns were everywhere, signs of recession nowhere. At the annual debutante ball at Houston's River Oaks Country Club, the ballroom gleamed with prosperity. Young debutantes, dressed in virginal white, took to the stage with their fathers, melting slowly to the floor as they curtsied.

Reuters

No need for a TARP

They have a lot to smile about: the coming-of-age ritual of the debutante ball, in which they were taking part, is still alive and well in some bits of America. Texas, California, New York and many states in the South still have balls in the winter, where American aristocracy comes glammed-up to celebrate young women's release into society. The custom, copied from the English tradition of presenting women at court, started in America back in the mid-18th century as a way for the wealthiest Americans to advertise the availability of their daughters on the marriage market. Today, two-and-a-half centuries and a women's movement later, the debutante ball is a nod to past eras, and young women of college age flock to them whether they are interested in an imminent marriage or not.

The cost of playing princess, as might be expected, is steep. For a girl to debut at the River Oaks ball, her parents must be members of the country club (which means paying a sky-high initiation fee and steep annual dues) and be able to afford the proper clothes. Dresses cost several thousand dollars, and it is not unheard of for families to spend over $10,000 on them. At the International Debutante Ball, held in New York in December, families paid $14,000 per table. And in some communities, festivities do not end with the ball itself. In Houston, not a few families were throwing extravagant post-debutante parties for their daughters.

As the recession becomes more visible and immodest displays of wealth just a little tasteless, all this may change. But those familiar with the history of debutante balls feel confident that they will not suffer permanent demise. They lost prominence during the 1930s, as well as in the 1960s and 1970s, when social upheaval and women's liberation made them seem anachronistic, or like cattle markets. But they survived those times. If the shimmer at River Oaks Country Club is any indication, they will survive these times too.

Lexington

Law v common sense

Jan 15th 2009
From The Economist print edition

Will Barack Obama protect Americans from his fellow lawyers?

Illustration by KAL

AMERICANS are still chuckling about the "pants suit". A man—a judge, no less—sued his dry cleaners for $54m for allegedly losing his trousers. A sign at the shop promised "Satisfaction Guaranteed". The plaintiff was not satisfied, so he cried fraud. He then used his highly trained legal brain to calculate the damages he was owed. He started with $1,500, a reasonable fine for consumer fraud. He multiplied it by 12, for the number of his complaints. Then by 1,200, for the number of days he was deprived of his trousers. And then by three, for the three owners of the dry-cleaning shop. After adding a bit more for mental anguish, the total came to $67m, but he kindly reduced it to $54m.

When the case was dismissed in 2007, many felt justice had prevailed. But the defendants had been put through purgatory and saddled with $100,000 in legal costs. They closed the shop and considered moving back to South Korea. The case illustrates "an important truth about human nature—that angry people can go nuts," observes Philip Howard, a campaigner for legal reform. What was most shocking about the pants suit was not the idiotic claim, he says, "but that the case was allowed to go on for more than two years." Some judges think even the nuttiest plaintiffs deserve their day in court. As the judge who let a woman sue McDonald's for serving her the coffee with which she scalded herself put it: "Who am I to judge?"

The rule of law is a wonderful thing, as anyone who has visited countries ruled by the whims of the powerful can attest. But you can have too much of a wonderful thing. And America has far too much law, argues Mr Howard in a new book, "Life without Lawyers". For nearly every problem, lawmakers and bureaucrats imagine that more detailed rules are the answer. But people need to exercise their common sense, too. Alas, the proliferation of rules is making that harder.

At a school in Florida, for example, a five-year-old girl decided to throw everyone's books and pencils on the floor. Sent to the head teacher's office, she continued to wreak havoc. Her teachers dared not restrain her physically. Instead, they summoned the police, who led her away in handcuffs, howling. The teachers acted as they did for fear of being sued. A teacher at a different school was sued for $20m for putting a hand on a rowdy child's back to guide him out of the classroom. The school ended up settling for $90,000. Understandably, many schools ban teachers from touching pupils under any circumstances. In New York City, where more than 60 bureaucratic steps are required to suspend a pupil for more than five days, teachers are so frightened of violating pupils' rights that they cannot keep order.

The relentless piling of law upon law—the federal register has 70,000 ever-changing pages—does not make for a more just society. When even the most trivial daily interactions are subject to detailed rules, individual judgment is stifled. When rule-makers seek to eliminate small risks, perverse consequences proliferate. Bureaucrats rip up climbing frames for fear that children may fall off and break a leg. So children stay indoors and get fat.

The direct costs of lawsuits are only one of the drawbacks of an over-legalistic society. Too many rules squeeze the joy out of life. Doctors who inflict dozens of unnecessary tests on patients to fend off lawsuits take less pride in their work. And although the legal system is supposed to be neutral, the scales are tilted in favour of whoever is in the wrong. Because the process is so expensive and juries are so unpredictable, blameless people often settle baseless claims to make them go away. The law is supposed to protect individuals from the state, but it often allows selfish individuals to harness the state's power to settle private scores.

A hint of hope

Will any of this change under Barack Obama? At first glance, the odds are poor. The new president is a lawyer from a party dominated by lawyers. His vice-president publicly thanked God last year that lawyers are such a problem for corporate America. When Mr Obama was in the Senate, he once voted for a mild curb on jurisdiction-shopping by class-action lawyers, but otherwise tended to vote against tort reform. And Democrats in the new Congress are itching to reward the lawyers who donated so generously to their election campaigns, for example by revoking the (admittedly short) statute of limitations on pay-discrimination claims, allowing lawyers to mine decades-old grievances.

On the plus side, Mr Obama will probably never face another Democratic primary contest, so he no longer needs to outdo other Democrats in cosying up to the trial bar. And he seems to understand how to weigh the benefits of new rules against their costs. A good sign is his expected naming of Cass Sunstein, a Harvard law professor, to head the office within the White House that vets new regulations.

Mr Sunstein is a level-headed fellow. Though a friend of Mr Obama's, he finds the "cult-like atmosphere that occasionally surrounds him" distasteful, fretting that it might make his advisers too deferential. Mr Sunstein wrote a book, "The Cost-Benefit State", encouraging policymakers to ponder trade-offs when crafting environmental and other regulations. He co-wrote another, "Nudge", examining how governments can use gentle coaxing rather than legal cudgels to achieve socially desirable ends. He is vigilant against unintended consequences. He cautions that crises, such as the one afflicting the financial sector, can provoke regulators to overreact. He appals the left by asking whether so many health-and-safety regulations are necessary, or even constitutional. He is less radical than Mr Howard, who wants to create specialist courts for medical malpractice claims and to give judges and officials far more authority to consider the common good when making decisions. But Mr Sunstein will tell Mr Obama some things he needs to hear, and there is a sporting chance that Mr Obama will listen.

Canada

A sticky ending for the tar sands

Jan 15th 2009 | CALGARY
From The Economist print edition

eyevine

A boom based on extracting oil from tar sands turns bad

LOOK west from the office towers of the energy companies that dominate Calgary, and the view is spectacular: rolling prairies rise to tree-clad foothills, with the jagged, snow-capped peaks of the Rockies on the horizon. Looking down, however, is more unsettling. The city is dotted with motionless construction cranes poised over the pits of abandoned projects. A five-year energy boom here in the administrative heart of Canada's oil patch and in the tar sands far to the north has ended. The only debate is how painful and persistent the bust will be—not just for the biggest city in Canada's richest province, Alberta, but for the whole country.

Alberta, which produces two-thirds of Canada's oil and gas, has been here before. The wrenching oil slump of the 1980s still looms large in the public consciousness. Companies fled the province and thousands abandoned homes they could no longer afford. "The situation is much different this time," insists the energy minister, Mel Knight, whose Progressive Conservative Party has ruled the province since 1971. Not all of the differences, however, are positive ones.

Mr Knight thinks continuing demand from places like China and India will mean that oil, and thus his province's economy, will recover faster this time. However, two decades ago there was nothing like the current global credit crunch. Also, Alberta now extracts 60% of its crude from its tar sands (those in the business think "oil sands" sounds nicer), a much bigger proportion than in the 1980s, and concern about the environment and carbon-based fuels is far stronger now.

When news broke in December that construction had briefly halted on The Bow, the showpiece headquarters of EnCana, Canada's largest independent energy firm, it sent shock waves across Calgary. The 58-storey tower designed by Lord Foster, a British architect, is both a symbol of Alberta's new role as Canada's economic engine and a poke in the eye for Toronto, the traditional corporate headquarters. The Bow's owner says it still needs C$400m ($327m) of financing to finish the job. Up north in the tar sands, many projects are being postponed, as the credit crunch adds to the woes caused by low oil prices and high labour and material costs. Petro-Canada and its partners put the giant Fort Hills project on hold after the estimated costs rose to around C$25 billion from C$14.1 billion in just over a year.

Extracting oil from the sands took off in the late 1990s, boosted by technological advances that greatly reduced costs. Sitting on the equivalent of 173 billion barrels of crude, the provincial government

dreamed of making Alberta a new Saudi Arabia (with moose instead of camels). Although some, such as Peter Lougheed, a former premier, called for "orderly" development, a wild rush ensued, causing provincewide labour shortages. Even servers at fast-food restaurants had to be lured with an iPod or other inducements. Now, though, employment is slumping: Steve Vetter, a manager at a firm that services the gas industry, says it recently had 50 applicants for one job; two years ago it would have been lucky to get any.

Extracting oil from tar sands causes more carbon emissions than traditional drilling. At some projects, leaks of toxic material have polluted waterways. So even if the credit crunch eases and the oil price steadies, Canada's tar sands may face tougher scrutiny from their main customer. The United States has hitherto been an enthusiastic buyer but the incoming Obama administration, packed with environmentalist hawks, may prove much less so, especially as the Democrats also control Congress. Henry Waxman, a Californian green crusader, has become chairman of the House energy committee. He wrote part of an energy bill passed in 2007 that seemed to ban American government agencies from buying oil produced from the tar sands.

It will be a further damper on investment in Alberta if the Obama administration enforces the ban. Canada's prime minister, Stephen Harper, who will meet Mr Obama soon after his inauguration, said this week that the tar sands would be one of the stickier subjects on their agenda.

On top of the oil bust, Canada's other commodity exports, such as lumber, are also suffering collapsing demand. After years of good growth, the economy will shrink this year. Mr Harper says it will take up to five years of "big, comprehensive" government stimulus to dig it out of the deep, black hole it is in.

Brazil's army

But what is it for?

Jan 15th 2009 | SÃO PAULO
From The Economist print edition

A philosopher redesigns an army

WHEN Roberto Mangabeira Unger swapped life as a philosopher and Harvard law professor for a place in Brazil’s government, he was given a small ministry from which to think about the future. From this perch, Mr Unger has already produced a proposal for regularising land tenure in the Amazon. He also has a grand scheme for redesigning the world economy (with help from his former pupil, Barack Obama). His most recent plan is a blueprint for Brazil’s armed forces—an unusual task for a man whose previous life involved writing long, gnomic books about “the radicalisation of indeterminacy”.

There are some traces of the philosopher in his “National Defence Strategy”. Conscription, which Mr Unger is keen to continue (but which many youngsters avoid), is described as a “republicanising space”. But in some respects his report reiterates the military top brass’s traditional preoccupations, including the urge to master new technologies such as nuclear energy (to power submarines, not make bombs) and create a domestic arms industry, and a mild paranoia about Amazonia.

Brazil’s army occupies an ambiguous place in national life. Its officers, fired with a faith in progress imported from France, replaced the monarchy with a republic in the 19th century. The army has often seen itself as a force for nation-building, laying down roads and putting up hospitals. But it has also seized power at times, such as in the 21 years to 1985, during which time one member of the current cabinet was tortured for her political views.

When Brazil became a democracy again it managed to keep the army out of politics but did not define a clear new role for it. Brazil’s territory has not been seriously threatened since the 1860s, when together with Argentina and Uruguay it crushed little Paraguay. The armed forces now talk a lot about flexibility, though this is not so much a voguish notion as a reflection of the difficulty of imagining threats to a country that is almost instinctively pacifist. Mr Unger uses the word flexibility 31 times in his 70-page review.

In the past few years, however, the government has started to think about projecting power abroad. Since 2004, Brazil has commanded the United Nations’ intervention in Haiti. After a slow start during which the mission was plagued by unclear objectives, it is now held up as a great success amid the awful failures in Congo and Somalia, according to Richard Gowan of the Centre on International Co-operation at New York University, who has observed Brazilian marines in action.

A second use for the army, featured prominently in Mr Unger’s plans, is in the policing of the Amazon region. “The Amazon is a bit like the Mediterranean was at the beginning of the 19th century,” says Alfredo Valladão of Sciences Po, a French university, “full of smugglers and pirates, and without much effective state presence.” The former military government had a fixation with the idea that a long, jungly border made the country vulnerable and that foreigners coveted Brazil’s forests. Boosting troop numbers to deter illegal logging and ranching would thus be a return to two old modes of military thinking: defending the forests from invaders and extending the reach of the state.

Venezuela's indigenous people

A promise unkept

Jan 15th 2009 | MACHIQUES
From The Economist print edition

Indigenous Venezuelans get welfare but, so far, not much land

THE Medellín ranch lies in the foothills of the Sierra de Perijá, a forested mountain range on Venezuela's border with Colombia. It is the front line of a simmering conflict between ranchers and the indigenous Yukpa people, some of whom, claiming these lands as ancestral territory, have occupied nine nearby ranches. Their dispute illustrates the gap between the rhetoric from Hugo Chávez's socialist government, championing the rights of indigenous peoples, and the reality.

Reinaldo Fernandez

Handouts are not much help to the Yupka

Only around 2% of Venezuela's 28m people are of unmixed Indian blood. The constitution, which President Chávez fathered in 1999, recognises their right to "the lands they ancestrally and traditionally occupy." That is potentially more than half the national territory. The constitution said these lands should all be demarcated by 2002 but this task has barely begun.

Last August four Yukpa leaders, wearing red warpaint and carrying bows and arrows, held a press conference in Caracas. They accused ranchers of employing gunmen to harass and even kill them. The ranchers deny this and accuse the government of encouraging the ranch invasions. At night, local ranchers, armed with shotguns and hunting rifles, patrol the properties most at risk of invasion. Francisco Vargas, the owner of the Medellín ranch, says it has been in his family for three generations. "So far as I know," he says, "my grandfather didn't kill a single Indian. These lands were bought, and I have the documents to prove it."

The Yukpas are divided. Some oppose the land invasions and even support the ranchers. "Invasions are very bad," says Rosario Romero, a Yukpa woman. "The ranchers worked for what they have. In the sierra there's lots of land to cultivate maize and other crops." She adds that, contrary to what radical Yukpa leaders say, her parents never suggested these lands were theirs. Her community had never received government help until Mr Chávez came along, she says, "Now we get money and food." However, this encourages indolence. Many Yukpa women have married non-Amerindians, as she has done, "because the Yukpa men don't want to work."

Charo Hernández of Provea, a human-rights group, says that across Latin America governments are giving indigenous people handouts rather than development, greatly damaging their communities. Mr Chávez's government passes laws to favour them but does not implement them, she says. His fellow socialist Evo Morales, Bolivia's president, has also struggled to keep big promises on Indian land rights.

Mr Chávez insisted last year that, if it had to choose between landowners and Amerindians, "this government is with the Indians." On October 12th, a day on which much of the Americas commemorates Columbus's landfall but in Venezuela is now "Indigenous Resistance Day", the president presented the Yukpa with titles to some blocks of land. But this fell far short of recognising their full rights to 60,000 hectares (150,000 acres) they claim as ancestral territory. The land-demarcation commission promised to resolve this claim within months. But Mr Chávez then said "there is only one Venezuela, and we are not going to divide it," claiming that unnamed foreign interests were seeking to break up the nation. Since then, the issue appears to have been quietly shelved.

Dissent in China

The year of living dissidently

Jan 15th 2009 | BEIJING
From The Economist print edition

For the government and its critics, a calendar mined with sensitive anniversaries

Illustration by Claudio Munoz

THE months ahead will be busy for Chinese dissidents. A string of sensitive anniversaries will evoke numerous petitions calling for political change. In December more than 300 of the country's most prominent activists issued a wide-ranging appeal for democratic reform. On January 12th a group of them were at it again, no less quixotically, with a demand for a boycott of national state-owned television.

As China's economic growth falters and unemployment rises, political activists—marginalised during the past few years of prosperity—will become a bigger worry to the government. The 20th anniversary on June 4th of the quashing of the Tiananmen Square protests will be the highlight of the dissident calendar. For Tibetans it will be the 50th anniversary on March 10th of an uprising that led to the Dalai Lama's flight into exile in India. Followers of Falun Gong, a quasi-Buddhist sect, will want to mark the tenth anniversary on July 22nd of its banning. Ever fearful of instability, the government will be especially anxious to quell dissent in the build-up to celebrations on October 1st of 60 years of Communist Party rule.

Dissidents can take some pride in their first salvo of the season. Their petition, known as Charter 08, which they issued online in early December to mark the 60th anniversary of the UN's Universal Declaration of Human Rights, was initially signed by 303 intellectuals. They included a wide range of lawyers, journalists, academics and activists. Organisers say that thousands more have added their names (by sending their details to an e-mail address), although the identities of many of them are difficult to verify.

Charter 08's name was intended to recall that of Charter 77, a human-rights manifesto circulated by dissidents in Czechoslovakia in 1977. The Chinese version called for everything from private ownership of land to multiparty democracy. It said social tensions were building up and the number of protests was rapidly increasing, "indicating a tendency towards a disastrous loss of control". Democratisation, it said, could "no longer be delayed".

The authorities disagree. They quickly detained the chief organiser, Liu Xiaobo, a veteran Beijing activist, and threatened or questioned dozens of other signatories. Chinese internet-service providers removed

postings about the document. A blog-hosting service, Bullog, home to several personal sites supportive of the charter, was shut down. A search in Chinese for the words Charter 08 on Google's Chinese search engine now produces only a standard warning that "according to local laws, regulations and policies, some results have not been displayed". Dai Qing, a prominent author and signatory, says the charter is unlikely to galvanise the public now that many cannot find it online to read.

The call for a boycott of the state broadcaster CCTV suggests some dissidents have not been deterred. Among the 22 people who signed the petition are seven, including its drafter, Ling Cangzhou, from Charter 08's first group of signatories. The petition accuses CCTV of playing down reports about protests and other negative news. It mentions a CCTV report broadcast in September last year praising the quality controls on milk-powder production by Sanlu, a leading dairy company. Sanlu was revealed just a few days later to have been selling tainted baby formula that caused thousands of infants to fall sick.

The contaminated milk scandal, in which many other Chinese milk producers were also implicated, heightened public suspicion of officialdom just as concerns were beginning to grow about the impact on China of the global financial crisis. With a total of nearly 300,000 children affected by the milk, the government feared unrest. On January 1st police in Beijing detained five parents of sickened children for several hours, apparently to stop them holding a press conference to complain about compensation arrangements.

Officials allowed the press little access to the trial on December 31st of Sanlu's boss, Tian Wenhua, and three other executives. Press reports say Ms Tian might be sentenced this week. Several officials have lost their jobs in connection with the scandal but none has been taken to court. Xu Zhiyong, a Beijing lawyer, says courts have ignored collective lawsuits he has filed on behalf of affected families. He is now planning to bring their cases to the Supreme Court. One of Mr Xu's aides speculates that the government, anxious to put the tainted-milk affair behind it, wants families to accept out-of-court settlements.

Even the official media have given warning that 2009 could be troubled, as the economy wobbles. *Liaowang*, a weekly magazine, quoted a senior journalist as saying that China was entering a "peak period for mass incidents" (the usual official euphemism for protests and riots). The authorities, he said, could be tested by "even more conflicts and clashes".

But few—even among dissidents—envisage upheaval on the scale of the pro-democracy protests in 1989. Hu Xingdou of the Beijing Institute of Technology says the public appetite for rapid political change still seems low. This month China's police chief, Meng Jianzhu, said that as long as Beijing was stable, the whole country would be stable. To mark the anniversary festivities of the founding of the People's Republic, the authorities will pull out every stop to ensure a trouble-free capital.

Vietnam's press under pressure

Muting the messengers

Jan 15th 2009 | SINGAPORE
From The Economist print edition

New limits on the freedom of speech

LIKE their counterparts in China, Vietnam's ruling Communists seem even more than usually sensitive to criticism. This month two leading reformist newspaper editors, Nguyen Cong Khe, of *Thanh Nien* (Young People), and Le Hoang, of *Tuoi Tre* (Youth Daily), were both told that their contracts would not be renewed, apparently because they were too good at their jobs. Their papers have assiduously uncovered official corruption, most notably with a joint exposé in 2006 about a crooked transport-ministry road-building unit. The journalists behind that story were punished by a Hanoi court last October for "abusing democratic freedoms". Now it looks as if their editors, too, have been culled. A spate of other arrests last year suggests a wider clampdown.

Ever since the start of *doi moi* (renewal) reforms in 1986, economic liberalisation has been accompanied by a gradual political loosening. There are around 700 newspapers in circulation. All are government controlled, but some are relatively outspoken. Meanwhile, a young, tech-savvy population has taken to reading opinion on the internet, in blogs penned by pseudonymous authors. These commentators are questioning government policy with increasing zeal. A day after the two journalists were arrested last year, their newspapers openly attacked the government's actions, hitting a few raw nerves. The government now also wants to curb the pesky bloggers, announcing rules in December restricting politically sensitive content on the internet.

AFP

Read all about it (or not)

One consequence may be a loss of steam in the drive against official corruption. Despite some highly publicised successes, critics contend that only low-ranking officials have so far been charged under a 2005 anti-corruption law. So it looks as if the government has moved to neuter the press before a big fish is caught. But David Koh, of Singapore's Institute of South-East Asian Studies, says that Vietnamese journalists are not always blameless. Some newspapers, facing intense competition for readers, have resorted to making up the "news". Tran Le Thuy, a former journalist at *Tuoi Tre*, argues that in the absence of a proper libel or privacy law, the state has no tools for correcting alleged untruths other than politically-laden charges such as "abusing democratic freedoms".

All this comes at an inopportune time, as cracks have started to appear in Vietnam's economy. Fears of a currency crisis shook investor confidence last April. Now, demand for Vietnam's manufactured exports has plummeted, and foreign investment is likely to be constrained by the global credit shortage. The country faces the prospect of the sharpest economic decline in a generation. The Economist Intelligence Unit, a sister company to *The Economist*, forecasts that growth will slow from 6.1% in 2008 to just 3.2% in 2009.

With thousands of Vietnamese likely to lose their jobs this year, the risk of social unrest in the country will surely rise. The government might be tempted to reassert its authority by quashing all criticism. However, sacking and jailing journalists and bloggers rather than corrupt officials is unlikely to win it many friends.

Thai politics

The first hurdle

Jan 15th 2009 | BANGKOK
From The Economist print edition

But there are many more to come

AP

Abhisit's laughing now

THE high-wire act that hoisted Abhisit Vejjajiva into Thailand's prime minister's office passed its first electoral test on January 11th. Voters replaced 29 members of parliament disqualified by the courts last month, in an election-fraud case that toppled the last government. Bangkok also elected a new governor after the previous one resigned in a procurement scandal. The results were a victory, of sorts, for Mr Abhisit, Thailand's fourth leader in a year. His coalition picked up 20 of the 29 vacant parliamentary seats; seven went to his Democrat Party. The party's candidate easily won the Bangkok race, retaining its hold on the all-important capital. Coalition partners delivered seats in the north and north-east, vital in any future election.

With an increased majority in parliament, Mr Abhisit appears better placed to outlast his predecessors. That should cheer Thailand's business lobby, which, with the army, underwrote the back-room deal that brought the Democrats to power. But the social and economic tensions that have threatened to tear Thailand apart are still largely undimmed. The economy is reeling from the global slump and months of anti-government protests that peaked in a weeklong seizure in November of two airports. A $3.3 billion fiscal stimulus approved this week by Mr Abhisit's cabinet should help. But foreign investors are still spooked by the chaos unleashed by the People's Alliance for Democracy (PAD), the rabble that occupied the airports and the government's offices.

Mr Abhisit has promised to bring protesters who broke the law to justice. But a PAD ideologue, Kasit Piromya, who refers flippantly to the jolly mood of the airport sit-ins, is now foreign minister. In protest at his appointment, opposition rowdies have threatened to picket next month's summit of the Association of South-East Asian Nations. To keep protesters at bay, the annual meeting, originally to have taken place in Bangkok in December, has been shifted to the seaside resort of Hua Hin.

With the PAD brought into the fold, it has been the turn of red-shirt protesters loyal to Thaksin Shinawatra, a former prime minister ousted in a coup in 2006, to take to the streets. During by-election campaigns, they hurled rotten eggs at their opponents. This did not seem to help Puea Thai Party (PTP), the latest incarnation of Mr Thaksin's once-invincible electoral machine. It won only five of 13 seats held by its precursor. Four others went to an erstwhile ally that may soon defect to the government, leaving the rudderless and divided PTP in lonely opposition. Its patron, Mr Thaksin, is living abroad and wanted at home for a corruption-related jail sentence. Little wonder that former allies, such as Newin Chidchob, an influential power broker in the populous north-east, have concluded that the game is up.

It is still, however, much too early to count out Mr Thaksin or his loyalists. A few by-elections swayed by local personalities do not demonstrate a national swing toward Mr Abhisit. He still has to convince rural voters that his administration is not about to reverse its predecessors' populist policies. The generous stimulus package in April should help. The success of Mr Newin and other coalition bosses in winning rural seats has bought the Democrats some breathing-space. But a slowing economy may yet bring more nasty shocks.

Bhutanese refugees in Nepal

Point of no return

Jan 15th 2009 | GOLDHAP AND THIMPHU
From The Economist print edition

Going west rather than home

"I HOPED the king might ask us to come back. But it's been 19 years and we still haven't been called back," Vidhyapati Luitel laments. Toothless and wheezing, the 79-year-old solemnly holds up his Bhutanese citizenship card. He and his family also have title deeds for land they owned in Gelephu in southern Bhutan, where his father migrated in 1919.

Now, though, home is a small bamboo hut in Goldhap, one of seven camps where over 100,000 Nepali-speakers have been living since—they say—fleeing or being ejected from Bhutan after 1990. There had just been big demonstrations, and some violent acts of terror, by members of the ethnic-Nepali minority. This followed new laws which deprived many of them of citizenship, strictly imposed the national Tibetan-related culture and ended the teaching of Nepali in schools.

Mr Luitel says soldiers started knocking on doors at midnight and asking who had demonstrated. He says that he had not, but it made no difference. "They took some young and old people to the river bank," he says. "They made us get down and beat us hard with a stick. Later they told us to leave the country and go to Nepal." Others say they were imprisoned, tortured and only released on condition that they sign documents promising to leave Bhutan.

Such accounts are dismissed by the government in the Bhutanese capital, Thimphu, a pleasant town of clean streets and bracing mountain air. A minister, Yeshey Zimba, says the allegations of violence are untruthful propaganda. "That is not in the nature of the government nor the people of Bhutan to do such things." Indeed, the then king did on several occasions ask ethnic Nepalis not to leave. But most testimony says officials and soldiers ignored this. The government maintains, though, that most of those who left were illegal immigrants. Mr Zimba says many Nepali-speakers entered the tiny country, then "felt comfortable" and so stayed. "But they are not Bhutanese." Many Nepali-speakers remain among the population; some are government ministers.

Bhutan admits that some of those who left are its citizens but says the number is small. That assertion seems doubtful in the camps, where elderly people abound and the idea of Bhutan as home seems deep-held. But two recent developments appear to be dimming the refugees' hope of returning. One is the growth of new far-left militant groups in the camps. Festering in Khudanabari camp, one young man says that northern Bhutanese have been resettled on land abandoned by those who fled. He praises a bombing campaign launched to overthrow the Bhutanese government. The emergence of such militancy has caused alarm in Bhutan.

Moreover, in the past year refugees have started leaving the camps to live in the West, a process instigated by America. Helped by the International Organisation for Migration, over 6,000 have left, and more are on their way. They know they will probably never see Bhutan again. At the airstrip nearest to the camps, two busloads arrive for a flight. Many, especially the elderly, look apprehensive. In Goldhap camp, Mr Luitel's wife says she is too old to move to America but has few illusions about returning to her birthplace. "There might be a new king in Bhutan but I guess they will not take us back," she says.

The war on Myanmar's border

Unequal struggle

Jan 15th 2009 | MAE SOT
From The Economist print edition

Less for freedom than survival

ONE of Asia's longest-running wars gets no less vicious as it gets older. For six decades the Karen National Union (KNU) has resisted the government in Yangon—inaptly known, these days, as the State Peace and Development Council or SPDC, a brutal junta. The biggest of Myanmar's myriad insurgent groups not to have reached a truce with the SPDC, the KNU's armed wing is now fighting desperately for survival in the mountainous Thai border region around the town of Umphang.

This month SPDC soldiers razed the base camp of one of its seven brigades: a newish settlement equipped with solar power, piped water, fish-holding tanks and medical facilities. Soldiers are now sleeping rough in dense jungle. Several hundred civilians, their homes in ashes, huddle under makeshift shelters.

Fighting alongside the SPDC are soldiers ostensibly belonging to a rival Karen militia, the Democratic Karen Buddhist Army (DKBA)—a loose coalition of KNU defectors, drug-runners and freelance thugs. The armies often mount attacks from Thai soil. That side of the border is more navigable, and is not strewn with landmines. The KNU's David Thackrabaw accuses the SPDC of pursuing a scorched-earth policy against both fighters and the civilian population. Another KNU commander, Nerdah Mya, his base in cinders, says his army has no "location" any more and is "always on the move". But he denies the war is in a critical stage. The KNU has been coping with such hardships for years.

Umphang was once home to one of Thailand's finest teak forests, logged by the KNU, in the days when Thailand tolerated it as a useful buffer to Myanmar. The region is also rich in antimony, gold, zinc and tin. The latest phase of the war began last June, with a concerted battle for control of the area. At times the Thai army has resorted to lobbing mortars at SPDC battalions, whose stray shells have forced the evacuation of Thai villages. Local farmers are "taxed" by both sides to get their produce to market.

Of some 140,000 refugees from Myanmar in camps in Thailand, more than 60% come from Karen state. They may be the lucky ones. Reports from western Karen state say that villages and crops there are often torched. The DKBA is much loathed, and many of its soldiers might join the KNU if it had any scent of victory. But at the moment, it has none.

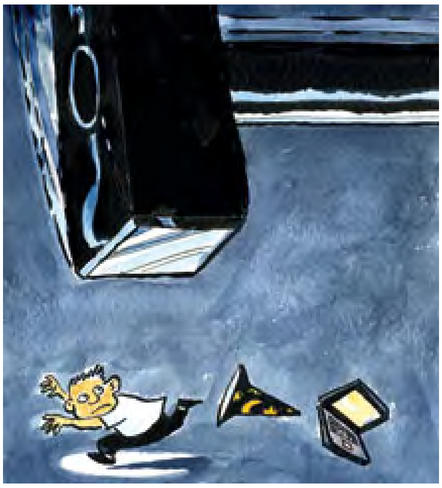
South Korea's financial prophet

Paranoid seclusions

Jan 15th 2009
From The Economist print edition

A prophet without honour in Seoul

Illustration by Claudio Munoz



FOR several months a blogger going by the name of Minerva, the Roman goddess of wisdom, has proved a severe irritant to South Korea's government. He made several correct financial predictions, such as the Korean won's sharp decline against the American dollar, and heaped scorn on President Lee Myung-bak and his finance minister, Kang Man-soo, for their handling of the economic crisis. This made him both a household name and a target for official persecution.

Indeed, since January 10th Minerva, who has been revealed to be an unemployed man, Park Dae-sung, has been in detention. Riot police raided his flat, finding the 31-year-old at his screen, surrounded by financial primers. He is under arrest on charges related to a posting on December 29th, asserting that in order to support the won the finance ministry had ordered financial institutions to stop buying American dollars. The ministry denies this, and prosecutors argue that the post contravened so-called "cyber-slander" legislation, and caused so much currency turmoil that the government had to spend the equivalent of $2 billion to support the won. Civic groups and opposition parties, infuriated by this apparent attack on free speech, have vowed to support him.

It is possible that Mr Park is just one of several Minervas. He denies writing a newspaper article published under his pseudonym. Others question whether a man with no formal economic training can grasp financial arcana (though many journalists claim to manage). But, however many Minervas there are, the government's sledgehammer to the blogger's nut does nothing to improve Mr Lee's perceived lack of a common touch.

Mr Park seems to have fallen foul of both the two main causes of official paranoia: the internet and the financial crisis. It has been alarmed about online activism ever since this helped opposition forces organise protests that brought central Seoul to a halt last year. Over the financial crisis, the finance ministry has urged foreign journalists to "care about the Korean people's psychology" and not use adjectives like "failing", "desperate" or "jittery" to describe markets. After all, say officials, press and people must stand together "to tackle this giant monster". As for the ministry's denial, traders agree that it did not put out an emergency order, as Minerva claimed. But all of the big banks in the foreign-exchange market, they say, were called and urged to curb their dollar purchases.

Nepal and the United Nations

Another fine mission

Jan 15th 2009
From The Economist print edition

The UN looks in vain for an exit strategy as the peace process stalls

AT FIRST glance, Nepal looks like that rare diplomatic prize: a successful peace process. A ten-year civil war is over. An election last April shocked the outside world by producing a victory for the former insurgents, the Maoists. But they rule in coalition, have done nothing drastic and seem settled in mainstream politics. The temptation for the outside world is to declare victory and shift attention to other, bloodier, conflicts.

That would be a mistake even if it were an option. The peace "process" has ground to a halt. On January 23rd the mandate of the United Nations Mission in Nepal (UNMIN) expires. It will, again, at the request of the Nepali government, be extended for six months, in the forlorn hope that the deadlock can be broken.

In a report to the Security Council this month, Ban Ki-moon, the UN's secretary-general, lamented the lack of progress: on drafting a new constitution for the country, which last year became a republic; on returning property seized by the Maoists during the war; and on curbing the thugs of the Maoists' Young Communist League. Above all, however, he rightly stressed the failure to implement commitments to merge the Maoist People's Liberation Army with the formerly royal Nepal Army.

The UN's main job in Nepal is to monitor former Maoist soldiers and their weapons. They are at present held in seven cantonment sites around the country, pending the "integration" of some of them into the army proper. But that is not happening, because few of the parties involved want it to. The army itself is loth to see Maoist guerrillas enroll other than as the most junior recruits.

India, Nepal's giant and often overbearing neighbour, is quietly backing the army in its intransigence. It seems alarmed by recent signs that the Maoists are cosying up to China. It regards the army as a bulwark against any radical lurch in Nepali policy. But India, always reluctant to see international involvement in Nepal, also wants the UN out. Its diplomats accuse UNMIN of "mission creep" to prolong its mandate. Even if that were true, however, it is hard to see how the UN can quit before the armies are integrated. And it is hard to see how the peace process can be counted a success so long as there are two armies, one of which appears to obey the civilian government only when it suits it.

The war in the Gaza Strip

The outlines of a settlement

Jan 15th 2009 | JERUSALEM
From The Economist print edition

How the Israelis might end their assault on Hamas

AP

IN WARS the fighting often intensifies on the eve of a ceasefire, as each side jostles for last-minute advantage. That may explain the step-up in fighting on January 15th, as Israeli ground forces thrust deeper into Gaza City, at one point shelling the main United Nations compound and reportedly setting a hospital on fire. For the escalating violence also coincided with a quickening of diplomatic efforts to end the devastating three-week war.

The focus of the diplomacy is in Cairo, where the Egyptian government has been receiving emissaries from both Israel and Hamas. Speculation from Israel suggested that there might soon be a ceasefire in place: Israel would not immediately pull its troops out of the battered Gaza Strip but would stop shooting, in return for Hamas ending completely its already faltering rocket bombardment of Israel.

Israel's preference is a truce that keeps maximum pressure on Hamas. The Israeli army would stay on the outskirts of Gaza City and reserve soldiers would remain mobilised, the better to persuade Hamas to accept a longer-lasting ceasefire that would also include arrangements to cut the flow of weaponry smuggled to its fighters through the tunnel system beneath Gaza's border with Egypt. Only then would the Israeli army withdraw and Israel lift its economic blockade.

It remained to be seen, as *The Economist* went to press, whether Hamas could bring itself to cease firing with the Israeli troops still inside the Strip. That could look perilously like a defeat. Hamas has failed to inflict significant casualties on the Israeli invaders and is showing signs of stress and division (see article). The Palestinian death toll exceeds 1,000, including hundreds of civilians. Many of its installations—and many other buildings in Gaza—have been reduced to rubble.

Israel is bracing itself for a new wave of global opprobrium once the world's press is finally allowed into Gaza and reports first-hand from the ruins. But support for the war among the Israeli public has remained broad (barring the Israeli-Arab minority) and solid.

When the guns fall silent Israel can also turn back to its elections, due on February 10th. In fact the campaign never really stopped. Inter-party and interpersonal rivalries seeped into the cabinet war-room despite the ostensible suspension of political hostilities. Ehud Olmert, who resigned over corruption

charges and will step down as prime minister once a new government is formed, has been the most gung-ho of the senior ministers. On January 12th, in rocket-stricken Ashkelon, he vowed that Israel's "iron fist" would keep smiting the enemy. "It's a test of willpower, us against them," he told a gathering of local mayors. His critics say his eye is really on his legacy, and above all on the opportunity to erase the memory of the inconclusive war against Hizbullah in south Lebanon in 2006.

Mr Olmert and Tzipi Livni, the foreign minister and his successor as leader of the centrist Kadima party, have been overshadowed in the running of the war by the defence minister and Labour Party leader, Ehud Barak. A former army chief of staff, he is back in his element, in the field with the troops, speaking their language, with cameras and microphones in attendance. His ratings, deep in the doldrums before the war, have surged back almost to respectability. He is not on a par with Ms Livni and the Likud's Binyamin Netanyahu, who remain neck-and-neck in the polls. But whichever of them wins the prime ministership will probably be keen now to keep Mr Barak at defence.

Mr Olmert and Ms Livni, by contrast, came to grief over a UN Security Council resolution on January 8th that called for a ceasefire. For Israel it was premature (Hamas rejected it too) and Ms Livni was blamed for failing to get it deferred. Mr Olmert then got into trouble by boasting that his own last-minute phone call to George Bush resulted in America abstaining instead of voting in favour, as the American secretary of state, Condoleezza Rice, had intended. She was "embarrassed", he asserted. "One hundred percent totally, completely untrue," the State Department spokesman shot back next day.

Mr Barak, on the other hand, projects prudence. Having had a good war so far, he seems keen to stop while Israel is still ahead. The next phase of the war, he said on January 14th, would oblige the army to reoccupy the so-called "Philadelphi Route", a narrow tract of land on the Gaza side of the strip's border with Egypt. Why, he asked, confront the incoming Barack Obama with this destabilising prospect?

Israeli aircraft have pounded the latticework of tunnels under the border. But even as the air force bombed them, Hamas was digging new ones. Israel wants international involvement to staunch this traffic. America and Germany have offered Egypt technical help, but Egypt has refused in the past to have any foreign forces monitoring its side of the Gaza border, and Hamas says that foreign troops on the Gaza side would be more "occupation". Neither Egypt nor Israel is keen on revisiting their 1979 peace treaty, which limits the number of troops Egypt can deploy in the border zone. But there are signs that both sides might accept Turkish troops.

The outcome of the border negotiations will determine the long-term success of "Operation Cast Lead" for Israel. In the short term, the government claims already to have restored its deterrent power. Favourable sentiment in the southern towns under rocket fire and among the reservists massed along the border bears this out. The atmosphere is very different from the despondent one during the month-long Lebanon war of 2006. Of course, Hamas's rockets have been less lethal and far less numerous than Hizbullah's. But Israelis ascribe their low civilian casualties to a sustained investment in reinforced concrete shelters and to the public's disciplined response to the Home Command's instructions, as well as to some lucky escapes.

This feeds into a defiant rejection of international condemnation. Years of missiles on their towns, the Palestinian *intifada* with its lethal suicide-bombings, the unrequited—as Israelis see it—withdrawal from Gaza in 2005, all these have created a collective sense among Israelis that they are right, whatever the world may say.

Hamas and diplomacy

The pressures mount

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From The Economist print edition

Hamas, like the Arab world, has been split on how to end the conflict

DESPITE mounting world pressure for an early end to the fighting, Hamas, like Israel, appears to be holding out for political gains. The rate at which Hamas militants fire rockets into Israel has steadily declined since the start of Israel's attack on December 27th, but Palestinian fighters, although armed with only light weapons, have been engaging Israeli soldiers in fierce gunfights near Gaza City.

Yet the Islamists, who seized power in Gaza in 2007, have also, like the Israelis, been divided as to the terms on which they want to end the fighting. While Hamas officials inside Gaza were signalling urgently for the bloodshed to stop, exiled leaders held out for all their conditions to be met. In particular, they insisted that they would never renounce their right to resist Israel by military means.

With Israel holding the advantage on the ground, and with many outside powers supporting Egyptian-led mediation, Hamas has faced heavy pressure to accede to peace terms that might leave it in control of Gaza, but strip it of any ability to fight. Much of the effort by Egypt and other interlocutors, including Turkey, has been aimed at persuading Hamas leaders based in Syria, led by the telegenic Khaled Meshaal, to diminish practical expectations in light of the grim situation in Gaza, in spite of their ideological attachment to eternal combat.

There were signs that this effort was bearing fruit. Egypt's foreign minister, Ahmed Abul Gheit, announced, after the departure of a Hamas delegation, that he would be reporting a "fundamental shift" in the delegates' position to the Israelis. Hamas spokesmen, meanwhile, hinted that Egypt had modified some aspects of its proposed deal, making it more palatable.

Diplomats said that a possible truce package could start with a period of calm for several days, followed by wide-ranging talks to resolve issues such as border controls and long-term guarantees of non-belligerence. But whereas the Israelis argued for their troops to stay in place during the early days of the truce, Hamas demanded their immediate withdrawal from Gaza as the price of halting rocket fire.

The softening of Hamas's position appeared to reflect an appreciation that its only real card, the tactic of using public sympathy for Gaza to raise pressure on countries like Egypt, was not producing quick results. Popular anger over Arab impotence has certainly left regimes such as Egypt's and Saudi Arabia's, as well as the rump Palestinian Authority in the West Bank, looking increasingly isolated in the region. But these American allies have long accused Hamas of acting in the interest of its friends, Iran, Syria and the Lebanese Shia militia, Hizbullah, to sabotage chances for a regional peace.

Reuters

The Gaza crisis has deepened the division between the "resistance" and "accommodationist" camps, which is now spreading among the broader Arab public. With the appeal of peace with Israel fading daily amid the popular anger generated by Gaza, Arab "moderates" have been hard-pressed to explain their position. In the oil-rich emirate of Kuwait, nearly half the members of parliament voted to object to any visit by Mahmoud Abbas, the Palestinian Authority leader and head of Hamas's rival party, Fatah, on the ground that his stand against "Zionist aggression" in Gaza had been too feeble. An online poll run by the passionately pro-Palestinian al-Jazeera satellite channel claimed that some 90% of respondents reject Egypt as a mediator, because of its perceived bias against Palestinians.

Egypt and Saudi Arabia have come under intense pressure to attend an emergency summit of Arab leaders called by Qatar, the small emirate that funds al-Jazeera and has been a vocal advocate of Hamas. With some 15 out of 22 members of the Arab League agreeing to the meeting, the

dissenters, who say that it will amount to nothing more than grandstanding, and point to the fact that an ordinary summit is scheduled for next week anyway, face a barrage of opprobrium. The souring of inter-Arab relations is one reason why Egypt has enlisted Turkey, a growing regional power that has carefully nurtured good relations with both Hamas and Israel, to back up its own diplomatic efforts.


Divided we stand

Even inside Egypt, independent commentators have openly branded the country's 80-year-old president, Hosni Mubarak, a traitor to the Arab cause for helping to maintain pressure on Hamas by keeping Egypt's border with Gaza tightly sealed. The Muslim Brotherhood, Egypt's largest opposition group and an ideological ally of Hamas, says security forces have arrested some 860 of its activists since the start of the Israeli assault, providing an indicator of the scale of public demonstrations that have shaken Egyptian cities, despite massive and heavy-handed police action. Such raised emotions are likely to leave long-term scars, and may continue to destabilise countries like Egypt. But they seem unlikely to produce quick gains for Hamas. In 2006 Hizbullah emerged battered, but claiming victory, in its war with Israel. The likely outcome for Hamas is that it will claim at least a moral victory among Arabs but, like Hizbullah, find its strategic options reduced in Israel's favour.

The role of the media

A war of words and images

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From The Economist print edition

Despite devoting unparalleled attention to the media, Israel is losing the propaganda war

AFTER their last controversial war, against Lebanon in 2006, Israelis commonly blamed the press for sapping morale by covering the carnage too closely. Israel is now better prepared. The tactics it deploys on the media front are as cunning and punchy as those its army has been wielding against Hamas in Gaza.

Back in November, few outside the region noticed when Israel suddenly blocked foreign reporters' access to the crowded Strip. But the information prong of Israel's Gaza offensive involves far more than the tight control of press access. Israel has fully utilised its expertise at *hasbara*, a Hebrew word meaning literally "explanation", but referring more broadly to image promotion. Platoons of on-message spokesmen are available to foreign reporters in Israel at all hours of the night and day. Israel's army has also launched a website featuring selected videos that is dedicated, it says, to documenting the "humane action and operational success" of Israeli forces. Israel's foreign ministry, assisted by scores of pro-Israel groups worldwide, has enlisted thousands of volunteers, supplying them with regularly updated talking points to nudge editors, journalists and commentators to see the news from Israel's perspective.

Gaza itself has been subjected to an intense "psy-ops" campaign. As well as air-dropped leaflets, propaganda that blames Hamas for the violence is beamed out via hijacked Palestinian radio broadcasts, text messages and direct calls to mobile phones. Some Gazans report receiving calls from apparently sympathetic fellow Arabs, who then turn out to want suspiciously specific information about Hamas operatives in their area. Meanwhile, the destruction of Gaza's electricity grid makes it hard for those trapped inside the territory to communicate with each other or the outside world.

Israel's campaign has succeeded on the home front, with its own Jewish citizens remaining broadly enthusiastic about a war mostly portrayed in admiring terms. It has conquered the American House of Representatives, too, which voted on January 9th by 390-5 for a bill declaring "unwavering commitment" to Israel. And it has even won over Samuel Joseph Wurzelbacher, an American everyman who won brief celebrity in the presidential campaign for his forthright views as "Joe the Plumber". Dispatched by Pajamas TV to report from Israel, he declared that its ban on war coverage was a good thing.

Yet wider support among the American public for Israel in this conflict appears to be less robust than usual. A Rasmussen poll taken on December 31st showed that while 44% of Americans were still for Israel, 41% were against it, a relatively high figure. And that was before the bloody attack on a UN school and other such incidents. Global public opinion has also probably shifted against the Jewish state. Even inside Israel, human-rights groups, concerned that much of the normally outspoken local press has turned largely jingoistic, have launched a website to expose the mounting tragedy inside Gaza.

They suffer no lack of heart-rending material. Here, denying access to Gaza to all Western correspondents might have backfired on Israel. The result has been that it is Gazans themselves, including some 300 local journalists, who have kept the world focused on their plight. More significantly, the most watched Arab television news channels are all in Gaza, giving saturation coverage to the conflict, even three weeks after its start.

The English-language sister channel of al-Jazeera, with two reporters in Gaza, has flourished in the absence of Western competitors, such as CNN. Its coverage has been graphic but sombre in tone. This contrasts with the hyperbole on many Arabic-language networks, where charges of Israeli "genocide", mixed with unsubstantiated reports of Hamas's military successes, have been frequent, accompanied by dramatic music and filler material looping pictures of dead children.

Hamas has been largely sidelined from this effort, although its television still beams feebly, airing martial pomp and pre-recorded speeches. The group has even tried its hand at phoning threatening messages to

Israelis and posting propaganda on the internet. But what has really turned the tide is the ceaseless stream of appalling imagery that fills the Arab satellite channels. Their passion is certainly not always professional, but the gore, distress and misery they portray are all too real.

Gaza and the laws of war

A thousand tragedies. But is it a crime?

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Israel has been operating in the grey zone of international law

AFP

THE weeping of Ahmad Samouni was heart-rending. From a hospital bed in Gaza, the 16-year-old broke into tears as he told a television interviewer how several members of his family had been killed in an Israeli strike. "My brother was bleeding so much and right in front of my eyes, he died. My other brother Ismail, he also bled to death. My mum and my youngest brother, they are gone. Four brothers and my mother, dead. May God give them peace."

The plight of the Samouni clan stands out even amid the profligate bloodshed of Israel's war in the Gaza Strip. According to survivors, about 100 members of the clan had been gathered by Israeli soldiers in a building in the Zeitun district on January 4th. The next day, it was struck by Israeli shells or missiles, killing about 30. Worse, Israeli forces are accused of preventing Palestinian paramedics from helping the survivors for two days.

"This is a shocking incident. The Israeli military must have been aware of the situation but did not assist the wounded," said the International Committee of the Red Cross (ICRC), not usually given to emotive language or public complaints about violations of humanitarian law. Navi Pillay, the United Nations' High Commissioner for Human Rights, went further. The killings show "elements of what would constitute war crimes", she said.

Israel replies that its army has looked into the claims and found no record of the incident at Zeitun. It claims that it is targeting Hamas only, and promises to improve "co-operation and co-ordination" with the ICRC. But Israel is vague about whether it will conduct a further inquiry, and tends to be wary of outside investigation. It declined to co-operate, for instance, with a UN inquiry into a shelling incident that killed 19 civilians in Gaza in 2006. This concluded that "there is a possibility that the shelling…constituted a war crime".

Another contentious incident in this war was the killing of more than 40 bystanders on January 6th near a UN school that was temporarily housing refugees. Here the Israeli army says that its soldiers were attacked by mortars fired "from within the school" and responded with mortar fire. But the UN strenuously denies that Hamas fighters were in the school. There is also the alleged use of white phosphorous shells: permitted as a smokescreen, but not over civilian areas.

About 1,000 Palestinians have been killed, among them more than 400 women and children, in nearly three weeks of fighting. But Hugo Slim, author of "Killing Civilians", a book on the suffering of civilians in war, argues that although every civilian death is a tragedy, "not every civilian death is a crime". War crimes typically involve deliberate brutality or recklessness. The modern laws of conflict do not seek to ban war, or even to eliminate the killing of civilians; they merely seek to stop the most egregious abuses

and to limit harm to civilians as far as possible.

Short of arguing that Israel is deliberately massacring Palestinians (if so, many more would probably have been killed and Israel's warning leaflets would be superfluous), judging war crimes depends on the facts of specific incidents and subjective legal concepts. Is Israel discriminating between civilians and combatants? Are its actions proportionate to the military gain? And is it taking proper care to spare civilians in the crowded Strip?

A British government manual on the laws of war admits that, for example, the principle of proportionality "is not always straightforward", not least because attempting to reduce the danger to civilians may increase the risk to one's own forces. Moreover, if the enemy puts civilians at risk by deliberately placing military targets near them, "this is a factor to be taken into account in favour of the attackers".

Israel makes precisely such arguments. Its aggressive tactics, it says, are justified by the need to protect Israeli forces, and Hamas is to blame for civilian deaths by hiding rockets and other weapons in mosques. According to Israeli officials, Hamas's top leaders are hiding in a bunker under the overstretched Shifa hospital (which, however, has not been attacked).

The laws of war have their roots, in part, in early worries about the impact of military technology such as air bombardment and poison gases. But international law has found it easier to deal with low-tech mass killings at close quarters, as in the Rwandan genocide of 1994, than with the rights and wrongs of Western-style air campaigns. Civilians are repeatedly hit by NATO aircraft in Afghanistan, but there are only regrets, not court-martials.

In other ways, military technology has raised the bar for what is considered acceptable. The skies above Gaza are buzzing with surveillance drones. Israeli command-and-control systems are doubtless as sophisticated as American ones, which give commanders vast digital maps in which structures are individually numbered and clearly identified if they are not to be attacked; they even have "splat" graphics to estimate the area that will be affected by a blast. Mishaps do happen; on January 5th three Israeli soldiers were killed by one of their own tanks. But without more facts, it is hard to believe the Israelis did not know about the presence of civilians at Zeitun and at the UN school.

The charges against Jacob Zuma

Standing by their man

Jan 15th 2009 | JOHANNESBURG
From The Economist print edition

Another twist ahead of the national and provincial elections later this year

ON JANUARY 12th South Africa's Supreme Court of Appeal reinstated 18 counts of corruption, racketeering, fraud and tax evasion against Jacob Zuma. Yet, backed by his party, the ebullient leader of the ruling African National Congress (ANC) continues to insist that he will be the party's presidential candidate in national elections expected to be held in April. This adds further spice to polls already deemed the most important since the first post-apartheid elections in 1994. Unlike their counterparts in most other countries, South Africa's presidents do not enjoy immunity from prosecution. This means that the country's next head of state could find himself ignominiously hauled through the courts and even jailed.

The wily Mr Zuma will, of course, do his utmost to avoid such an eventuality. He has launched an appeal against the latest ruling. His aides are already deep in talks with the National Prosecuting Authority (NPA) in an attempt to cut some kind of deal allowing him, for example, to plead guilty to lesser charges.

Ever since Mr Zuma was first indicted in 2005 in connection with a 30 billion rand ($5 billion) arms deal in the late 1990s, he has protested his innocence, claiming he was the victim of a conspiracy aimed at thwarting his hopes of succeeding Thabo Mbeki, then still president. Mr Mbeki promptly sacked Mr Zuma as the country's deputy president, causing a rift in the ruling party that rapidly grew into an unbridgeable chasm. In December 2007, Mr Mbeki suffered a stunning defeat at the party's national congress in Polokwane when 60% of the delegates voted to make Mr Zuma party leader in his place.

However, nine months later, the High Court found that there had been unwarranted "political meddling" in the NPA's decision to charge Mr Zuma. Although no names were mentioned, the finger of guilt was firmly pointed at Mr Mbeki's people. The ANC's powerful National Executive Committee took this as the pretext to call on the increasingly unpopular Mr Mbeki to step down as the country's president.

Now, however, the Supreme Court of Appeal has ruled that the High Court overstepped its authority in reaching such "inappropriate" findings on political matters. The Supreme Court also dismissed the finding of a violation of Mr Zuma's constitutional rights, thereby automatically reinstating the charges against him.

All this will overshadow the ANC's election campaign, and comes as sweet music to the Congress of the People (known by the acronym COPE), the ANC breakaway party set up by anti-Zuma activists in the wake of Mr Mbeki's resignation. Despite its newness, COPE is regarded as the first serious multiracial challenge to the ANC since the latter took over power from the last apartheid government 15 years ago. Since then, South Africa has been dominated by one party, with the former black liberation movement regularly winning 63-70% of the national vote. Although no one doubts that the ruling party will retain power in the national and provincial elections, the ANC fears that COPE, together with other opposition parties, could make inroads into its traditional support for the first time. Internal ANC research suggests that the party's support might fall below 60%, making it lose the two-thirds parliamentary majority needed to change the constitution to, say, grant immunity to sitting presidents.

At an ANC jamboree in the Eastern Cape on January 10th, a beaming Mr Zuma launched the party's election manifesto, including a promise to tackle corruption within the party. Calling for "change and continuity", the left-leaning manifesto is full of vague pledges to extend public services and welfare benefits for the poor, without explaining how this might be done in a sharp economic downturn.

On January 24th COPE is due to launch its own manifesto, also in the Eastern Cape, a province that it hopes to wrest from the ANC's control. The Eastern Cape is one of South Africa's poorest provinces and will be the main battleground of the election. Elsewhere the skirmishing has also begun, perhaps all too literally. Earlier this month a youth leader of the Inkatha Freedom Party was assassinated in Durban. More violence is expected.

Albinos in east Africa

A horrendous trade

Jan 15th 2009 | NAIROBI
From The Economist print edition

Saving those most at risk from prejudice and witch doctors

THE head of police in Tanzania's capital, Dar es Salaam, this week handed out free mobile phones to several hundred locals with albinism. This is a melanin deficiency that renders African skin pink and vulnerable to cancer, turns hair wispy and leaves eyes pale and impaired. Each phone comes with a "hot line" to the police. Albinos text in their location if they suspect they are being tracked by gangsters determined to kill them and harvest their body parts.

According to the Tanzania Albino Society, at least 35 albinos were murdered in Tanzania last year to supply witch doctors with limbs, organs and hair for their potions. The violence of the attacks and the prejudices they reinforce, both about albinos and Africa, have prompted Tanzania's government to act. It has appointed an albino woman as a member of parliament to champion the interests of some 200,000 albinos in the country. The albinos, for their part, have applauded the intervention as well as other measures, such as attempts to stamp out the use of the Swahili word "zeru" (meaning "ghost") for albinos. Nonetheless, they say that efforts to convict albino-killers have been thwarted by a rotten judicial system, with witch doctors using bribery or threats of spells to escape trial.

Alas, the killing of albinos has spread outside Tanzania's borders to Kenya, Uganda and particularly Burundi. On January 2nd an eight-year-old albino boy living in Burundi was hacked to death in front of his mother. The killers took his arms and legs. That attack followed another on a six-year-old albino girl in the same country. The killers tied up the parents, shot the girl in the head, and made off with her head and limbs.

Investigators say the body parts of a single murdered albino sell for over $1,000, with the skin and flesh dried out and set into amulets and the bones ground down into a powder. Artisanal miners in the gold and diamond fields directly south of Lake Victoria are the main buyers. Some sprinkle albino powder on the walls of their narrow pits, hoping for glitter. Uneducated and desperate to strike riches, they are taken in by witch doctors' stories of the wealth-giving properties of the potions.

Germany

Angela Merkel's big political year

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From The Economist print edition

AP

The imploding economy casts a grim shadow over German elections in 2009

THIS was the plan. Germany's super election year would start slowly. The three parties in the "grand coalition"—the Christian Democratic Union (CDU) and its Bavarian sister party, the Christian Social Union (CSU), plus the Social Democratic Party (SPD)—would spend much of 2009 talking up their economic achievements while probing one another for electoral weakness. Things would warm up with a string of elections in the early summer, simmer when three states vote at the end of August and boil over with the federal election on September 27th. Both the CDU-CSU and the SPD hoped then to win enough seats in the Bundestag to form a ruling coalition without the other.

Two events have torn up this plan. The political year will start more abruptly than expected, with a hastily scheduled election in Hesse on January 18th. More important, the economic and financial crisis means that the grand coalition suddenly has much less to boast about. The voters are now looking to parties that seem best able to steer Germany through its roughest economic patch since the war. This may not change the outcome, with the CDU's Angela Merkel still favoured to win re-election as chancellor. But she may well find herself presiding over a new grand coalition with the SPD.

In Germany, at least, economic worries seem to lead to demands for reassurance rather than change. In crises voters turn to governing parties that are in a position to alleviate them, suggests Oskar Niedermayer, a political scientist at the Free University in Berlin. The capitalism-bashing Left Party, which has its roots in East Germany's communists, has failed to convert popular anxiety into political gain: its backing remains stuck at about 10%.

On January 12th the coalition came up with a €50 billion ($67 billion) package of tax cuts and investment this year and next to help cushion the economy from the worst effects of recession. This is a turnaround for Ms Merkel, until now Europe's leading sceptic of expensive Keynesian fixes. As the economic outlook has deteriorated—output could shrink by 2% or more this year and hundreds of thousands of jobs will be lost—the political pay-off from a rescue package has risen, even if the measures look more impressive than they really are (see article).

How this pay-off is shared will depend both on the odd politics of the grand coalition and on how the crisis plays out. The SPD considers itself the architect of the package, insisting on lower health-care contributions, for example. Income-tax cuts are a consolation for the CSU, still traumatised by the loss of its absolute majority in Bavaria last September. Ms Merkel's own CDU grumbles that the sharp rise in the

budget deficit will make tax reform more difficult.

Yet the chancellor, who wields her powers with presidential aplomb, has a knack for taking more than her fair share of credit. The task of stopping her falls largely to Frank-Walter Steinmeier, the foreign minister and SPD nominee to challenge her for the chancellorship. It will not be easy. A reformist Social Democrat will find it hard to score points off a socially minded conservative. Ms Merkel's charisma deficit is an opportunity that the greyish foreign minister is unable to exploit. He cannot attack her crisis management, because it is his, too. More than half the voters want her re-elected; only a third back Mr Steinmeier. And on the economy, voters prefer the CDU to the SPD by a margin of 20 points.

If Ms Merkel prevails, it will be partly through sleight of hand. She presents herself as the matron of a grand coalition that embraces all Germans. But her preferred coalition partner is the liberal Free Democratic Party (FDP), which wants a slimmer state and economic reforms that she would rather not talk about. On today's opinion polls the duo would assume power after September, but only just.

The SPD is resigned to failing its first electoral test. The early election in Hesse became necessary when local Social Democrats failed to form a government with the Greens backed from outside by the Left Party, thereby breaking a promise not to co-operate with the rambunctious ex-communists. The caretaker premier, the CDU's Roland Koch, now looks likely to remain as head of a coalition with the FDP. The Left Party, which has marched into several state legislatures in western Germany, could now be ejected from Hesse's.

The CDU and the FDP may also team up to re-elect Horst Köhler to the largely symbolic job of president on May 23rd, when Germany will also mark the Federal Republic's 60th birthday. The two parties are expected to have a bare majority in the presidential assembly, made up of the Bundestag and delegates chosen by state legislatures. The SPD candidate, Gesine Schwan, has a slim chance only if some delegates defect and the Left Party backs her.

The European and local elections in early June will be the next popularity contest. Then will come a lull until late August, when three state elections will set the tone for the federal vote a month later. In Saxony the CDU premier is likely to be re-elected. In the eastern state of Thuringia and in tiny Saarland the burning issue may again be the SPD's dealings with the Left Party. That is because the Left's base remains in the east and Saarland is home to its co-leader, Oskar Lafontaine, a flamboyant populist defector from the SPD. In both states the SPD and the Left could together win most of the votes; in neither has the SPD ruled out a partnership. So when voters turn out for the federal election a month later they may be talking about one of the CDU's favourite subjects: the SPD's feckless relationship with the Left Party.

More and more, voters nowadays make up their minds at the last moment, which makes all predictions hazardous. With five parties likely to be in the Bundestag again, it is quite probable that neither the CDU-FDP tandem nor a left-leaning SPD-Green partnership will command a majority. The alternatives then would be an exotic three-party *ménage* (the two smaller parties joining either the CDU or the SPD); or, more likely, another four years of grand coalition. Unless, as unemployment soars, Germany's vote turns into a change election after all.

Germany's economy

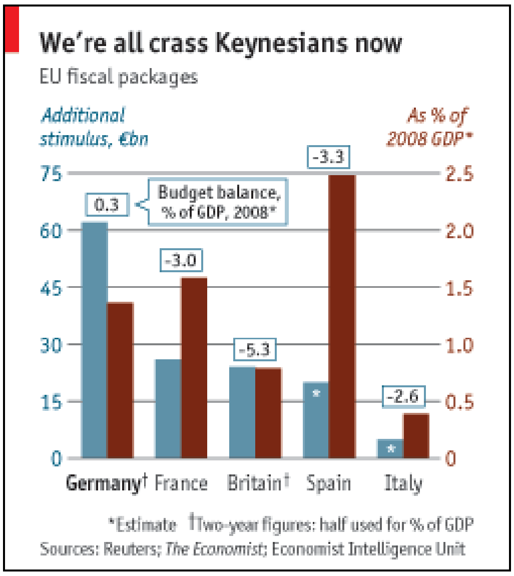
How very stimulating

Jan 15th 2009 | BERLIN
From The Economist print edition

Somewhat belatedly, Germany goes for a €50 billion fiscal stimulus

IN DECEMBER Angela Merkel said Germany, having recently announced extra spending of a mere €12 billion, would not then join a "senseless race to spend billions" fighting the recession. On January 12th her grand-coalition government decided it would after all be sensible to spend €50 billion ($67 billion) this year and next to mitigate the recession's effects. An "extraordinary situation" demands "extraordinary measures", Ms Merkel explained.

She was right the second time. Germany's economy is contracting sharply. It requires emergency aid to sustain confidence and prevent a collapse of demand. A fiscal stimulus worth a total of around 1.4% of GDP a year may lessen the pain, even if it is not big enough to end it. But is it being spent the right way?



There is least quarrel over the €17 billion to be spent on roads, schools, hospitals and so on, mainly through local authorities. As well as giving a short-term lift to employment, this should nudge up the economy's long-term potential growth. But the rest is a grab-bag of tax cuts and incentives that may serve the interests of the parties that lobbied for them as much as the wider economy.

Thus the Social Democratic Party promoted a cut in payroll taxes for health insurance and a €2,500 payment to drivers who trade in old cars for new, greener ones. The Christian Social Union, the Bavarian sister party of Ms Merkel's Christian Democratic Union, pushed to raise income-tax thresholds and cut the lowest rate from 15% to 14%. Some fret that in their haste to cut taxes the politicians may make future reform harder.

Nor will the jolt to the economy be quick. The income- and payroll-tax cuts will take effect only in July. And breadwinners worried about their jobs may not spend the extra money. "You need to focus on 2009," says Norbert Walter, Deutsche Bank's chief economist, who would have preferred a cut in value-added tax and a trade-in incentive for all sorts of durable goods, not just cars. The government counters that consumer spending remains stable, for now.

The stimulus package will be judged partly by the clean-up after it. Because banks shy away from lending, the government plans to guarantee up to €100 billion of loans to companies. That could lead to "state capitalism", worries Mr Walter, tempting the government into protecting unsound borrowers.

The extra spending, plus the fall in revenues caused by the recession, will push the budget deficit close to the euro-area ceiling of 3% of GDP this year, and over 4% in 2010, admits the finance minister, Peer Steinbrück. (That is still much less than some other euro countries.) To restore fiscal sobriety, the government plans a constitutional change to limit deficits and a fund to pay off debt. How to get out of the stimulus game may prove as critical as how to get in.

Russia, Ukraine and gas

War-war, not jaw-jaw

Jan 15th 2009 | MOSCOW
From The Economist print edition

The disappointing failure of efforts to end the gas wars

THE greater the build-up to a truce, the bigger the upset when it fails. This adage was confirmed as the gas war between Russia and Ukraine persisted this week. On January 12th, after fraught talks in Brussels, the Russians agreed to resume gas supplies to Europe via Ukraine. The next day the gas taps were reopened—but the gas did not get through. Ukraine said it could not handle the transit. "Unbelievable," seethed a senior Gazprom executive. It was clear that Ukraine had been stealing gas and was entirely responsible for blocking the flow to Europe, the Russians averred.

Ukraine retorted that Gazprom had deliberately tricked its European customers. Instead of restarting full supplies to Europe, it put too little gas into the system and chose a technically tricky route. Hryhory Nemyria, Ukraine's deputy prime minister, says that after Russian gas stopped flowing completely on January 7th, the pipeline was used to take gas from storage in the west of the country to industrial users in the east. Had Ukraine reversed course by transporting gas to the Balkans, it would have been forced to cut supplies to its own users.

European Union monitors, deployed to verify the transit of gas, could shed little light on the situation. But what is clear is that the interests of freezing consumers are coming second in this spat. Although few Europeans defend the Ukrainians, many are angry that Russia should seem keener to expose Ukraine as an unreliable transit country than to serve its ultimate customers (see article).

Russia has long argued that its gas contract with Europe should be separate from its bilateral one with Ukraine, and has sought direct or indirect control of the Ukrainian gas-transport system. As Rory MacFarquhar, an economist at Goldman Sachs, notes, the Russians have never come to terms with the fact that Ukraine, as the main transit country, is an integral part of the whole business. Now, he adds, Ukraine, whose bargaining power was its ability to disrupt transit to Europe, has chosen to exercise this "nuclear" option.

There are many hidden and conflicting interests in the row. That they have together produced such a lengthy crisis reflects institutional weakness in both countries. Russia and Ukraine have tried to discredit each other, but have ended up discrediting themselves. Both run the risk of lawsuits from frustrated consumers.

Vladimir Milov, a Russian opposition politician, thinks Russia wanted a clash with Ukraine, and says the firmness of its action and language resembles that seen in the war with Georgia last August. In both cases the aim was to discredit pro-Western leaders. And in both conflicts Russia blames America. Alexander Medvedev, deputy head of Gazprom, said this week that it looks like the Ukrainians "are dancing to the music which is being orchestrated not in Kiev, but outside the country." Yet Russia has run a better public-relations campaign than it did over Georgia. Far from shunning European intermediaries, the Russians have tried to engage the EU to put pressure on Ukraine.

Mr Putin's personal involvement has made the clash more political. "We will always proceed from the premise that we have a special historical relationship with Ukraine. Our actions are aimed not at worsening the situation in Ukraine, but on the contrary at improving it and ridding the Ukrainian people of all sorts of swindlers and bribe-takers," he said, even as he insisted that the row was commercial.

In both Ukraine and Georgia, Russia has exploited the failings of its opponents. Ukraine's political in-fighting, the existence of a controversial trading intermediary, its opaque system of gas distribution, the weakness of its law and the extent of corruption all make it vulnerable. Mr Putin has identified clan rivalries in Ukraine as a weak spot. President Viktor Yushchenko has undermined the efforts of his prime minister, Yulia Tymoshenko, to do a deal. He has tried to shore up his own flagging support by fulminating against Russia.

That Russia should try to exploit weaknesses is not surprising. But it is not clear that either country will gain from the stand-off. The Russians have called a summit in Moscow this weekend. Gazprom has lost $1.1 billion of export revenues and had to shut some 100 wells. Both countries' reputations have suffered. As José Manuel Barroso, president of the European Commission, put it this week, "Without judging intentions, there is an objective fact: Russia and Ukraine are showing they are incapable of delivering on their commitment to some member states."

Energy in eastern Europe

Gasping for gas

Jan 15th 2009 | BRATISLAVA
From The Economist print edition

Former Russian satellites in eastern Europe are hit hardest of all

TALK emptily of diversifying supplies while doing little and relying instead on cosy ties with the Russian gas business. That has been the common energy policy in much of eastern Europe in recent years. The row between Ukraine and Russia that has cut off gas to the region now makes it look a huge mistake.

AFP

Back to energy basics

Bulgaria has suffered the most. It depends on Russia for almost all its gas and is one of the most wasteful users of energy in the European Union. The government is in the hands of the Russia-friendly Socialists, who signed a long-term gas contract with Gazprom. It is secret, which arouses suspicion. The failure to hook the gas network up to other sources, or to build new gas-storage facilities, looks bad. State-owned industries and municipal heating enterprises are required by law to keep oil reserves but have not done so. Some, according to the local media, sold them corruptly, so were unable to switch fuels when gas supplies were cut.

Some private businesses have laid off workers and shut production. Neochim, a maker of artificial fertilisers, says the gas cut-off has cost it €100m ($132m). About 160,000 households in Sofia and other cities lost heating and hot water during a cold winter when temperatures fell below -10ºC. Many switched to electric heaters, overloading the power grid. Fire services say they were lucky not to see any big fires. Teachers had to choose between keeping children in cold classrooms or sending them to cold homes. About a hundred schools shut. Sofia zoo got emergency heating; prisons did not.

Amid the mild panic, most voters blame the government, which had promised that Bulgaria had enough gas reserves for two months. The energy minister complained that supplies were cut without notice, but then admitted that Russia warned him in mid-December. The government is nervous: a decade ago protesters stormed parliament and tried to burn it down. Despite public attempts to blame Ukraine, ordinary Bulgarians reacted differently. Internet campaigners suggested cutting the Russian embassy's heating. (Serbia has also seen anti-Russian protests.)

Both Bulgaria and Slovakia are threatening to reopen nuclear reactors closed as a condition of joining the EU. That has brought angry threats of legal action by the European Commission and Austria, a fierce critic of Slovakia's Jaslovske Bohunice nuclear-power plant. Slovakia, which depends on Russia for all its gas, has declared a state of emergency, forcing big energy users to cut consumption—including its flagship foreign carmakers. "We are on the brink of a blackout," said the economy minister, Lubomir Jahnatek.

When the gas returns, the debate will turn to plans to diversify supply. There is new interest in Nabucco, a pipeline to bring gas from Central Asia and the Caspian to Europe via Turkey. If built, Nabucco would be the only east-west gas route not controlled by the Kremlin. But there is no obvious big source of gas for Nabucco; and Russia's energy diplomacy has managed to sideline it in favour of South Stream, its own

project to bring gas across the Black Sea from Russia to the Balkans. Even Romania, once a staunch supporter of Nabucco, is wobbling. Half its gas imports come from Russia, but its leaders still seem ready to listen to offers from the east.

Charlemagne

Energetic squabbles

Jan 15th 2009
From The Economist print edition

Russia injects new fizz into the European Union's continuing debate over energy policy

Illustration by Peter Schrank

FOR a policeman on patrol, few calls inspire more gloom than a summons to a domestic dispute. There is a high chance of stumbling into a shouting match, in which right and wrong are beyond the power of outsiders to judge. There the officer stands, big boots and crackling radio horridly out of place in a homely kitchen, as family members exchange accusations. Yet sometimes developments can bring sudden clarity. Policemen know just what to do if somebody threatens to use force, or seriously disturbs the neighbours.

In a way the gas dispute between Ukraine and Russia since January 1st is like just such a family feud. The Russian prime minister, Vladimir Putin, has called Ukraine's leaders "criminal", and accused them of stealing gas meant for Europe. The Ukrainian president, Viktor Yushchenko, insists that Russia is to blame for cutting gas supplies that cross his country en route to European customers, and has described the opaque arrangements by which Russian gas reaches Ukraine as "stinking".

Yet even in the worst-affected European Union country, Bulgaria, the head of the state gas monopoly, Dimitar Gogov, said he had no idea why no gas was coming in. "I no longer know whom to believe," Mr Gogov confessed this week. "Russia says one thing, Ukraine says another." And what goes for Mr Gogov goes for others, right up to the senior EU officials trying to sort out the mess. Nobody knows what is really going on inside the dispute that pits the Kremlin-controlled gas giant, Gazprom, against the squabbling political leadership in Ukraine (with a few oligarchs thrown into the mix for good measure).

The situation also resembles a domestic dispute in that it has spiralled out of control and now threatens the neighbourhood. For all that the EU is desperate not to take sides, Europeans have come to an important realisation. Russia has had several opportunities to make its point but still shield EU consumers from harm. Yet it has ignored them, choosing to put its bilateral dispute ahead of Europeans' welfare. The Russians began the row by merely reducing gas supplies, but then—after accusing Ukraine of siphoning off gas meant for the EU—cut them completely, guaranteeing misery for many customers in the midst of a nasty cold snap. Later, as EU leaders tried to agree terms for sending monitors to verify flows in and out of Ukraine, Russia played endless political games. It demanded a hard copy of one written agreement, for example, and insisted on a manual of instructions for the monitors' work before allowing their deployment.

EU officials argue that the decent thing would have been to restart supplies as early as January 9th, and wait for promised papers to arrive later, given the scale of the humanitarian suffering, and the fact that restarted gas would take some 36 hours to reach some shivering end users. Yet, regardless of the rights and wrongs of its wider dispute with Ukraine, Russia chose not to do the decent thing. Turning the taps off completely has "backfired" badly on Russia, says a diplomat. "That is not to say the Ukrainians have not behaved stupidly and badly. But the Russians overplayed their hand."

This has shocked EU governments enough to ensure that the gas dispute has not been a repeat of last summer's war between Russia and another ex-Soviet republic, Georgia. Then, as so often, the EU split into those who condemned Russia as an aggressor and those who argued that Russia had merely "overreacted" to a gross provocation by irresponsible Georgians. Ministers from some countries went even further, making sympathetic noises about Russian claims of secret American involvement in the Georgian war. Yet this time hints by a Gazprom boss, Alexander Medvedev, that Ukraine's policies were being influenced from abroad (ie, from America) were greeted in Brussels not with knowing murmurs of assent, but with rolled eyes of disbelief. Ukraine's behaviour has certainly caused anger, but Russia has gravely damaged its credibility.

Pipes and whistles

Not everybody has been converted. The Italian prime minister, Silvio Berlusconi, has played the role of a bored policeman outside a nasty "domestic", telling gawking neighbours there is nothing to see. Europeans should not be worried by the crisis, he said. "I can understand Gazprom's reasons," added Mr Berlusconi, whose country has ample gas storage and who has forged close ties with Mr Putin, including a plan for Italy to co-operate in building a gas pipeline, South Stream, that would tighten Gazprom's grip on EU gas supplies.

Germany's stance may be shifting, however, according to some officials. Europe's largest economy has a famously snug relationship with Gazprom, with politicians and industrialists insisting that the Russian firm is a reliable energy supplier and a welcome potential investor in the EU. Germany (and to a lesser extent France) has fought moves to create a transparent, liberalised single European market for gas, which would do more than anything else to curb Russia's ability to use gas to divide and rule. Germany still defends the right of big energy suppliers to own transmission systems (which makes life harder for new entrants). But at a meeting of energy ministers this week, the Germans talked of the need both for fuller market integration in Europe and for new pipelines, including Nabucco, which is meant to ship gas from the Caspian to Europe without going through Russia.

EU leaders have long talked of building a transparent gas market, with more interconnections between European countries so that gas can easily flow to the hardest-hit. Politicians say the latest gas crisis has proved the need for action, not words. An EU summit in March will put that to the test: governments will be asked to approve the spending of real money on real projects. If they fail the test, Europe's internal squabbles, like many real-life domestic disputes, could yet have tragic consequences.

Airport expansion

Gordon's Heathrow gamble

Jan 15th 2009
From The Economist print edition

The prime minister's insistence on a third runway will add to his political woes

AP

THOUGH well trailed, it was still a shocker when it happened. After months of objection, conjecture and delay, the government finally gave the go-ahead on January 15th to a third runway and sixth terminal at Heathrow airport. The expansion could mean an increase in flights over London from 480,000 a year to 700,000. Howls were heard from opponents who have doggedly fought the plan for years.

To appease concerns about the environmental impact of a third runway, Geoff Hoon, the transport secretary, promised that only newer aircraft which meet strict noise and emissions criteria would be allowed to use it when it opens in 2019 or 2020. He also promised a high-speed railway line linking St Pancras station in London and the north via a loop to Heathrow.

For the prime minister, Gordon Brown, the £9 billion ($13 billion) project has become a personal litmus test of his willingness to take what he calls "the tough, long-term decisions" to safeguard Britain's economic competitiveness. He is also keen to be seen creating jobs, even if they are likely to be years away.

Cheering him on are the aviation industry (particularly BAA, the airport's owner, and British Airways, the dominant airline at Heathrow); big business; and two large unions. Ranged against them, however, is an equally powerful coalition, including environmentalists, London's mayor, those who live near Heathrow, the two major opposition parties and at least 50 Labour MPs. Mr Brown even had to overcome the disquiet of nearly half his cabinet, who feared that the government's legally binding commitment to reduce by 80% Britain's carbon emissions by 2050 would be made to look ridiculous.

The scheme's supporters claim that the new runway is essential because Heathrow is at the limit of its capacity, the main reason for its chronic lack of punctuality, and thus in danger of losing its status as one of the world's busiest hubs to rivals on the continent: Frankfurt, Paris's Charles de Gaulle, Madrid and Amsterdam all have more runways than Heathrow and some are building new ones. They argue that unless Heathrow holds its own, London will become an increasingly unattractive place to do business. In particular, they say that attracting transfer passengers, who are inherently mobile, is vital because they help to sustain an extensive route network.

Mr Brown is peculiarly susceptible to such arguments. During his ten years as chancellor, he often had his ear bent by senior City people about the awfulness of Heathrow. The government is also very close to

both BAA and BA, the principal beneficiaries of a Heathrow expansion. Although both firms were privatised in the 1980s (and BAA is Spanish-owned) they are still quaintly regarded in Whitehall as "national champions". The bond between BAA and the Department for Transport (DfT) is so close that it is sometimes hard to see where one ends and the other begins.

When the DfT wanted to show that a much bigger Heathrow would not be in breach of European pollution rules, it asked BAA to supply much of the data. The government's own Environment Agency has expressed scepticism over the way in which the favourable forecasts were arrived at. The communications directors of both BAA and BA were recruited from Downing Street. Any legal challenge to the third runway is almost certain to allege collusion between the firms and the DfT.

But will it happen?

In fact, it is far from a foregone conclusion, despite the government's announcement, that the third runway will ever be built. BAA is thought unlikely to file a planning application before late 2010. Although the planning process for big projects has been streamlined, entrenched opposition to this one means that bulldozers will probably not roll before 2015. Greenpeace, a pressure group, has bought land on the proposed runway site and intends to delay the planning process with procedural challenges.

Most important, David Cameron, the Tory leader, opposes the third runway on both environmental and economic grounds. With the approval of her boss, the shadow transport minister, Theresa Villiers, has warned any companies pitching for the work that they will not be compensated if her party forms the next government. And should a hung parliament emerge from the next general election, the Liberal Democrats, who would form part of any coalition, also oppose expansion.

Mr Brown may well find his Heathrow decision politically costly. Voters have no reason to trust government pledges that flights on the new runway will be limited to environmentally sound aircraft. Too many environmental promises have been issued before now and ripped up. The promise to build greener high-speed rail links is equally unreliable: there is no serious analysis, no planning, no money earmarked for it—in short, no indication that the government is pursuing this option seriously. Least reassuring of all, the government continues to bang on about Heathrow's lack of capacity, apparently unaware that air-traffic projections made during the longest period of sustained economic growth since British statistics have been comprehensively collected might need to be updated.

The Tories' lead has widened in recent polls, and it is not only in west London, near the airport, that Mr Brown's Heathrow decision could lose Labour votes. And it was all avoidable. Later this year, the Competition Commission will almost certainly insist that BAA surrender its airport monopoly in the south-east by selling Gatwick and Stansted. With these smaller London airports under new owners that have every reason to compete with Heathrow, additional capacity at Gatwick, for example, could have emerged when required. Naturally, BAA and BA are dead set against that outcome. But it is at least odd that Mr Brown should be willing to risk so much on their behalf.

Getting banks to lend

A gallant effort

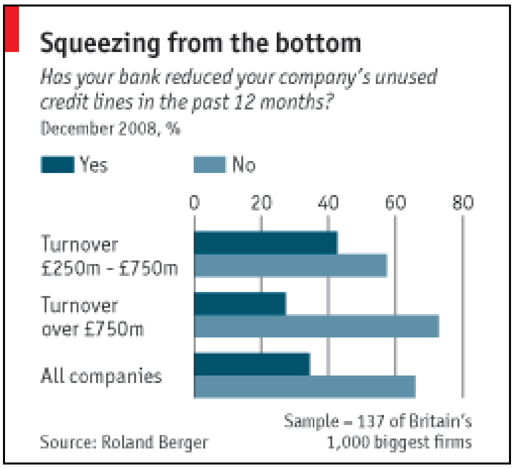
Jan 15th 2009
From The Economist print edition

A business plan that misreads the banks' dilemma

LORD MANDELSON, the business secretary, has long complained that credit-crunched banks are not lending enough to small and middling businesses. His earlier efforts to find credit for small firms (£1 billion—$1.46 billion—of help for small exporters and the like) were clearly not enough: companies are going bust and shedding jobs with increasing frequency. So on January 14th his Department for Business, Enterprise and Regulatory Reform (BERR) launched another gallant attempt to get more credit flowing.

Under BERR's new scheme, the government will guarantee 50% of up to £20 billion-worth of bank loans to companies with less than £500m in annual turnover. Bankers will keep the job of assessing credit, proffering to the government portfolios of qualifying loans (mainly short-term support for working capital to keep firms ticking over). In exchange for the guarantee, banks are to pay a premium and promise to lend money to other firms to which they would not otherwise have extended credit. Smaller schemes will be set up too: in one, the government will guarantee three-quarters of the financing for £1.3 billion in small-company loans; in another it will provide two-thirds of a £75m fund co-sponsored by banks to swap debt for equity in small firms. Lord Mandelson says he will return to the attack to assist big companies and ease credit insurance, which helps firms maintain their supply chains.

This is well-intentioned stuff. Companies big and small are being starved of bank credit, and this is having dire consequences for businesses and the economy in general. About 84 businesses are going bust each day, compared with around 65 in happier times, according to BDO Stoy Hayward, an accounting firm. More than one-third of firms in a sample of British companies polled in December by Roland Berger, a consultancy, said that banks had cut their unused credit lines over the past year (see chart).



But Lord Mandelson's plan has two problems. First, it may not be workable. Banks reluctant to lend will pay a premium for insuring their lending only if the fee is minimal, which offers the taxpayer little protection; and officials will have trouble discerning whether banks' "other" lending was truly not contemplated.

More important, the plan misreads the nature of the banks' dilemma: the parlous state of their balance-sheets, despite the billions of taxpayers' money already poured into them. The Basel 2 international bank-capital regime and the global accounting standards known as IFRS—to say nothing of security analysts and rating agencies—are forcing banks to hoard more capital, anticipating that deepening recession will slash asset values further. This amplifies an already appalling business cycle: together, Basel 2 and IFRS are "like procyclicality on speed", says Brandon Davies, a risk consultant. To maintain capital ratios, banks can either try to raise more money or cut lending. As stockmarkets are spectacularly unreceptive, most are choosing the latter course.

The lack of capital is particularly explosive at the moment because banks' annual financial statements are falling due. Bankers and regulators are haggling now with auditors about how to present their accounts. An auditor worried about whether a bank will be a going concern in 12 months' time may feel bound to write a cautioning paragraph, known as an "emphasis of matter". This could shake the public's already low faith in banks. Bank directors too must attest that they are running going concerns, and risk legal consequences if they are knowingly wrong.

Various ways to relieve the banks' lack of capital and get them lending again were suggested at a parliamentary committee hearing on January 13th, echoing urgent debate elsewhere. Nationalisation came up—but few regard the government as a good allocator of capital. Another suggestion was to relieve banks of some of their worst assets and put them in a so-called bad bank, as Swedish and Mexican

banking authorities did in previous banking crises. “The state is the only one that can take this on and perhaps make money out of it,” the committee heard. A bad bank would need to mop up nonperforming and deteriorating corporate and property loans totalling about £260 billion, calculates JPMorgan, a bank, stumping up £53 billion to support the risky assets or siphoning off deposits along with them.

In the longer term, some bank experts would like to see capital-adequacy and accounting rules made more countercyclical. But companies strapped for cash today can hardly hang on for that solution.

Scotch whisky

Off to see the world

Jan 15th 2009 | SPEYSIDE, MORAY
From The Economist print edition

Amidst the gloom, single malts are flourishing

MOST recession-blighted manufacturers worry that their next order is likely to be for mothballs. Not so Scotland's whisky makers: they are busy bringing old distilleries back to life and building new ones. The reason is not that the British are drowning their economic sorrows; it is that exports of single malts are booming.

"We were producing 6m litres a year," says David Cox, a director of the Macallan Distillery, whose whisky is the third-best-selling malt (by volume) in overseas markets. But on the wooded bluff overlooking the River Spey where Macallan has been made since 1824, stills disused since the 1980s have been brought back into use and two vast warehouses have sprouted. New capacity is adding some 2m litres a year, says Mr Cox, and land has been earmarked for still more expansion.

Though sales of whisky in Britain are broadly declining, consumption elsewhere has risen. In 2007 it reached 318m litres, a 15% increase on 1997, and £2.8 billion ($5.6 billion, at the exchange rates of the day), an 18% increase. Blended whiskies, it is true, faltered in 2008 but single malts forged ahead. Drinkers have got keener on the more expensive stuff (made from malted barley and generally matured for at least ten years) and less keen on grain and blended whiskies (usually kept for three).

The fastest-growing market has been East Asia—particularly China, where the value of whisky sales rose from £1m in 2001 to £70m in 2007, according to the Scotch Whisky Association, a trade body. In Moscow too there is a market for single malt that did not exist before.

The shift to this more exclusive tipple means that Mr Cox's distillery, which used to sell much of its product to whisky blenders, now keeps everything for its own lines. Most distillers do not have enough stock on hand to meet demand, thanks to a downturn in production in the 1990s. So many are rationing the amount they sell in order to have some ten- and 12-year-old stock to market in future years as even more expensive whiskies. Bottles of 30-year-old drink can fetch more than £1,000.

To slake the worldwide thirst, one distillery, Ardbeg on Islay, is breaking the ten-year rule and marketing a six-year-old malt under the label "very young", an eight-year-old ("still young") and a nine-year-old ("almost there"). Mr Cox muses about breaking out of the age straitjacket to mix eight-, ten-, and 15-year-old stock under a label such as "head distiller's choice".

Others are seizing the chance to make money now. The trade association says that in 2008 and 2009 a total of about £500m will be spent building six new distilleries, bringing two old ones back into use and expanding five sites. Firms profess to be unworried by recession, since whisky they make now cannot be sold for years anyway. They are confident that the Chinese and others, having developed a taste for malt in particular, will come back to it.

Dramatic evidence of this confidence can be seen at Roseisle on the Moray coastal plain where Diageo, a British multinational, is spending some £100m on a vast distillery. Looking more like a beached supertanker than the usual stone-walled pagoda-hatted plant, it is intended to pour out 10m litres of whisky a year.

It is a bold development, especially as the success of whisky's overseas marketing has been based on emphasising quality derived from more than a century of tradition and heritage. Whether connoisseurs take to Diageo's unashamedly modern, industrial-scale product is yet to be tested.

Social mobility

It's still not fair

Jan 15th 2009
From The Economist print edition

For many, opportunity remains frustratingly elusive

Illustration by David Simonds

ON JANUARY 13th Gordon Brown's government announced its latest attempt to improve the chances of the poor and undereducated. The smorgasbord includes bonuses of £10,000 ($14,575) to persuade talented teachers to stay in unpleasant schools, a little bit of cash (£57m) to provide free child care for particularly deprived two-year-olds, a tripling (to 45,000) of the number of state-funded loans for retraining and promises to help bright but poor children gain entry to university. All perfectly good measures—and perfectly indicative of the government's frustration.

Labour came to power in 1997 pledging to make Britain a fairer society. For all the billions of pounds and litres of sweat expended, progress—good at first—has been patchy overall. An OECD study last year concluded that Britons enjoyed neither equal opportunities nor equal outcomes. Income is shared out less evenly than in most rich countries (among OECD members, only Italy and America are more unequal). Opportunities for the poor to better themselves relatively are hard to come by: a father's income determines his son's to a greater extent in Britain than in any other OECD country. True, the study found that inequality and poverty were falling in Britain, but its data ran only until 2005. More recent information from Britain's Office for National Statistics suggests that the trend has now gone into reverse.

Mr Brown's concern for the disadvantaged is genuine, but there are baser political considerations too. Announcements about social mobility were combined with other pledges to introduce thousands of paid internships and guarantee loans to small businesses, in a bid to reassure voters that the government is doing everything it can to keep ordinary Britons in work through the downturn.

His party was elected almost 12 years ago in part because it had toned down the sort of socialist rhetoric that tends to frighten Middle England. But Mr Brown hails from a more traditional wing of the party than Tony Blair, his studiedly classless predecessor—and class, it seems, is now back on its agenda. Potentially the most significant announcement this week is that ministers are considering explicitly forbidding government departments from discriminating on grounds of social class. And Alan Milburn, a former health secretary who is leading a government commission on how to get more poor youngsters into professions such as medicine and law, frets that their access is being blocked by the sharp-elbowed middle-classes, who give their kids a leg-up by arranging valuable work experience and internships that few poorer parents can line up or finance.

The Tories look vulnerable on class: David Cameron is their first posh leader for decades, educated at Eton and then Oxford, and surrounded by political chums from the social elite. His background seemed not to matter much while the economy was growing and voters were getting richer. But there is nothing like a recession for sharpening an electorate's sense of envy.

International students

Build it, and they will come

Jan 15th 2009 | NORWICH
From The Economist print edition

Universities are going all out to lure foreign students

THE reception desk is festooned with posters and flyers for local events and London shows. The paintwork gleams, the bedrooms are spacious, the kitchens and bathrooms high-end. Around the corner are classrooms and a lecture theatre, and in every nook and cranny students are chatting, working and reading.

This newly-opened four-storey building is on-campus home and school to around 400 students at the University of East Anglia (UEA) in Norwich, all of them from outside the European Union. It was paid for and built by INTO University, a private company that markets UEA's courses and recruits students overseas. INTO hires the teachers, runs lessons, exams and social events, and guarantees the university a minimum number of students each year; UEA decides on course content and has final say over which students have made enough progress to be allowed into its standard degree courses. Profits are shared equally.

Students from outside the EU are vital to British universities' finances. Neither their numbers nor their fees are capped by government (UEA's foreign-student fees, around £10,000 a year for most courses, are pretty standard; nationally, fees paid by overseas students in higher education total some £2.5 billion). They keep open departments in some subjects—science, engineering—that are shunned by locals. And the more of them a university attracts, the higher it rises in the ever-more-important international league tables.

Britain has been a magnet for foreign students, thanks in part to the reflected glory of Oxford and Cambridge and to the fact that English is the global language of business. But its attraction may be weakening. Too often universities offer their paying guests a shoddy service. A common gripe is that they provide little customised support in return for their whopping fees; language problems and social isolation are rife. Locals, too, can resent foreign students, particularly if large groups come from a single place and don't mix, or if their poor English holds up a whole class, or if there is any hint that they are admitted preferentially for financial reasons.

Other countries are trying harder these days to grab a slice of the lucrative foreign market. American institutions are recruiting more foreign students, and an increasing number of universities around the world—in Germany, Japan and China, for example—are offering courses taught in English. Yet another threat comes from Britain's stalling economy. Aware that overseas students are lured by the prospect of staying and working for a while after they graduate, universities recently persuaded the government to loosen constraints on their doing so. Now, however, jobs are scarce, which may make some parents think twice about investing a medium-sized fortune in a child's British future.

Universities are turning increasingly to private partners to help them solve these twin problems: the increasing recruitment of foreign students by other countries, and the need to offer suitable tuition for non-standard foreign learners while keeping home students happy. Since signing up UEA in 2006, INTO has made deals with four other British universities (and Oregon State University, its first partner outside Britain) and is in discussions with several more. Its founder, Andrew Colin, reckons nearly 30 other institutions have agreements with one of his four competitors.

It is striking that internationally mobile students do not choose the cheapest options: the top three destinations—Australia, Britain and America—are among the priciest. But it would be a mistake for universities to think cost didn't matter, says Robin Bew of the Economist Intelligence Unit, a sister company of *The Economist*. Although students are suspicious of the quality of free, or very cheap, higher education, big shifts in exchange rates are important when they make their final decisions about where to study. "The upturn in student recruitment to American universities in 2007 was, in our opinion, largely attributable to the falling dollar," says Mr Bew.

For the INTO students at UEA, a cheaper pound now is a pleasant boost to their spending power. For youngsters around the world weighing up their future educational options, it might just tip the balance in Britain’s favour.

Government information

Free-ish

Jan 15th 2009
From The Economist print edition

Four years on, the Freedom of Information Act is popular but underfunded

“PLEASE accept my apologies for the delay.”…“Unfortunately, I have been off for most of this week due to illness.”…“I hope that we will be in a position to respond by the end of next week.”…“I have been on leave.”…“The response is still being finalised.”

If waiting for a bus is frustrating, prising information out of Transport for London (TfL), the body that runs public transport in the capital, is worse. In November and December 2007, *The Economist* applied to see two TfL reports on the London congestion charge. There followed a delay worthy of the Northern Line: 18 e-mails gave nine different reasons for missed deadlines; it was two months before a response arrived, in the negative, and three more before an internal review confirmed that refusal.

The Freedom of Information Act, four years old this month, was supposed to eliminate such foot-dragging. Under its terms, public bodies must cough up information within 20 working days unless there is a good reason not to (there are 23 get-outs, from national security to personal privacy, mostly subject to a public-interest test). In the past four years some 400,000 requests have been made by the public, unearthing morsels on everything from hospitals’ death rates to departmental Christmas-party budgets (most lavish this year: the Audit Commission, whose job is to “promote value for money for taxpayers”).

But non-compliance is endemic. In November the information commissioner, Richard Thomas, rapped the Department for Communities for delays of up to 400 days in processing requests, and this week the Ministry of Justice admitted that it was late in replying to a third of its requests last year.

Part of the reason they can afford to be so relaxed is that the commissioner’s office is itself slow in pursuing complaints. This newspaper’s beef with TfL was referred to it last April but the matter is still being pondered. Mr Thomas says that about half his cases are dealt with in 30 days, but nearly a third take more than a year. A staff of just 53 has handled some 9,000 cases since the act came in. Its £5.5m budget will be no higher this year (and may even be cut), despite a projected 15% rise in the caseload.

That the money comes from the Ministry of Justice, which also advises the rest of Whitehall on how to deal with awkward requests, is a “slightly uncomfortable situation”, says Mr Thomas. He would rather be funded directly by Parliament, like his Scottish counterpart, Kevin Dunion, who enjoys a proportionally bigger budget. Achieving that, along with broadening the act’s scope to cover outfits such as private utilities and contractors engaged in public business, would be a good agenda for Christopher Graham. The current head of the Advertising Standards Authority is the ministry’s preferred candidate to replace Mr Thomas when he steps down in June.

The shadow cabinet

Personnel matters

Jan 15th 2009
From The Economist print edition

The Tories are on the prowl for big beasts of their own

ONE of the Conservatives' loudest boasts before the Labour Party was restored to respectability in the polls last autumn concerned the strength of the shadow cabinet. Not only did David Cameron, their leader, appear better suited to the premiership than the then-floundering Gordon Brown, but George Osborne, their Treasury spokesman, William Hague, the shadow foreign secretary, and others further down the Tory food chain seemed more than a match for their opposite numbers in government.

Mr Brown's bounce may now be receding (a Populus poll on January 13th gave the Conservatives their first double-digit lead since November), but so are those Tory boasts. Indeed, such is the disquiet over the party's failure to land hits on the government in recent months, and to sell its own ideas on dealing with the recession, that a reshuffle is mooted. Although Ken Clarke's enthusiasm for the European Union (EU) perturbs influential party donors, the former chancellor of the exchequer may be brought back for his much-needed experience and common touch. A new party chairman may also be appointed, even if Caroline Spelman, the incumbent, is cleared by a parliamentary investigation into her claims for expenses that has dogged her since last summer.

Mr Cameron's personnel problems are, in part, due to events. The sudden resignation of David Davis as shadow home secretary last summer deprived him of a heavy-hitter. Mr Osborne's stock has yet to recover from a brush with scandal, forcing the leader to carry the bulk of the party's economic message himself. And the pre-eminence of the economy as a political issue has meant that talented spokesmen with other portfolios are little noticed.

Critics say that these problems are compounded by Mr Cameron's failure to persuade his colleagues to shed the distractions of lucrative second jobs. An attempt to do so was reputedly ditched in December when some shadow-cabinet members, who bridle at MPs' salaries and claim that outside interests make them more rounded politicians, threatened to resign. On January 14th Mr Hague—whom Mr Cameron described in the same interview as his deputy "in all but name", which may worry Mr Osborne—said he would drop other commitments as the next election approaches. But many activists want an outright ban on second jobs. Time spent fulfilling the obligations of directorships is not spent bashing ministers and preparing to replace them, they say; and the spectacle of senior Tories with multiple jobs may jar with voters struggling to keep just one.

Some Conservatives downplay the importance of personnel, arguing that voters seldom notice any opposition spokesman other than the leader. They claim that Labour successfully relied on Tony Blair, whose image adorned the cover of their manifestos in the 1997 and 2001 general elections. If having a range of individual talent is so important, they wonder, why are the Liberal Democrats not doing better, when their impressive front bench includes several members who racked up significant achievements in business before entering politics? That party's recent reshuffle passed without notice outside the Westminster village.

Those who disagree point to the impact a single appointment—Lord Mandelson's, whose business portfolio Mr Clarke may be asked by Mr Cameron to shadow from the House of Commons—has had on the government's fortunes. And though Mr Blair dominated the Labour Party in opposition, voters were still vaguely familiar with senior colleagues such as John Prescott, Robin Cook, David Blunkett and Margaret Beckett, who held various jobs once Labour was in power.

Where both sides concur is on the dearth of options available to Mr Cameron. Whereas Mr Brown can call upon the likes of Alan Milburn, the former health secretary who has been appointed to chair a commission on social mobility, almost 12 years in opposition has left the Tories short of experienced figures who are both well known and well liked. Some grizzled backbenchers complain of a cult of youth under Mr Cameron, but three rumoured candidates for the shadow cabinet—Mr Clarke, Mr Davis and Lord Trimble, the former Ulster Unionist leader who is now a Tory peer—are in their 60s. Iain Duncan Smith, a former

Tory leader who is also supposedly being considered for a comeback, is no spring chicken either. It is a good time to be grey in the Conservative Party.

Global migration and the downturn

The people crunch

Jan 15th 2009
From The Economist print edition

AFP

The economic slump is battering migrants. For tens of millions of people working outside their homelands, life is becoming much more precarious

WORKERS waiting at airports: some flying off to seek modest fortunes, others returning to poor homelands whose main export is people. These images of the global labour market in the early 21st century are starting to fade as economic times get harder, both in countries that take in migrants and (partly as a result) in countries that send them out.

Consider, for example, the changing fate of the "Kigezi kids", a group of young workers, mostly graduates, who gather each month to gossip about life in London. They hail from southern Uganda—an area of green hills and endemic poverty—and their meetings are usually pleasant chats over a barbecue, when they compare property portfolios and community projects back in Africa.

Now, the mood is darkening. Several work in London's troubled financial-services sector. Six months ago their prospects seemed secure, but the eruption of the worst financial crisis since the 1930s has spread anxiety. One woman, after four years of study and employment, is poised to go home. Another is distraught after an offer of a permanent job was withdrawn. More recent arrivals moan that it is tough to find work, even the menial sort. Daily living grows harder: some split the cost of housing, others walk to save on bus fares.

All are startled by the recent slide in the value of the pound. The Kigezi kids are struggling to help relatives in Uganda who, battered by high prices of rice and maize flour, send frequent requests for money. "There is a feeling that it's getting hard to be here. I'm praying I don't receive any text messages," says one man. A few are quietly changing their mobile-phone numbers to avoid demands for cash. "It is even creating bad blood with relatives who think their sons and daughters in London are no longer being helpful," he says.

Their troubles are emblematic of migrants' growing woes all over the world. Rates of migration soared in recent decades as the likes of Britain and America enjoyed rapid economic growth and sucked in labour. Around 200m people now live outside their homelands, some 3% of the global population. The proportion of foreign-born people in many Western countries has surged well above 10%: this includes Greece and

Ireland, from where emigrants used to leave. Spain, where a construction boom helped to create a third of all new jobs in Europe in recent years, sucked in 4m foreigners (especially from Bulgaria and Romania in the EU, plus Ecuador and other bits of the former empire) between 2000 and 2007.

As economies turn, migrants suffer. Many industries where they predominate (tourism in Ireland, financial services in Britain, construction in America and Spain) have shed jobs fast. Spanish unemployment is already 12%; many thousands of migrants are said to be claiming benefits. Spain's government is seeking ways to get some to move again. It says hopefully that 87,000 will re-emigrate under a new "plan of voluntary return", which lets migrants claim future unemployment benefits early, in two lump sums, if they hand in residence permits and work visas and promise to stay away for three years. As much as $40,000 is apparently on offer, per migrant. Yet few have shown interest.

As migrant workers suffer in America—general unemployment is over 7%, a 16-year-high, with Hispanic workers hit especially—the message sent home is "don't come". It has been received clear enough, for now. A study of 120,000 Mexican households published in November showed emigration (almost entirely to America) had slumped by 42% from two years earlier. Border arrests have fallen equally fast. The value of remittances has also tumbled, says Mexico's central bank.

Into the unknown

As long as the slump was limited to rich countries, the impact on migrants was relatively predictable: some would be diverted to faster-growing emerging economies; some might choose not to migrate; some would go home, at least for a time.

Early evidence suggested that migration was indeed slowing. Data released in November showed 577,000 immigrants arrived in Britain in 2007, 14,000 fewer than the year before (although emigration fell faster, lifting net migration). Last year probably saw a much starker drop. Similarly a survey in Ireland late last year suggested that of 200,000 Polish migrants, around a third expected to leave within a year.

On January 14th a Washington, DC, think-tank, the Migration Policy Institute (MPI), published a study of the impact of recession on migration in America. It concludes that the foreign-born population there has already stopped growing, after years of rapid expansion. Illegal migrants in particular have responded to the slump: in the past year or so the stock of unauthorised migrants has stopped rising. As the recession worsens, the number of foreign-born in America might yet decline.

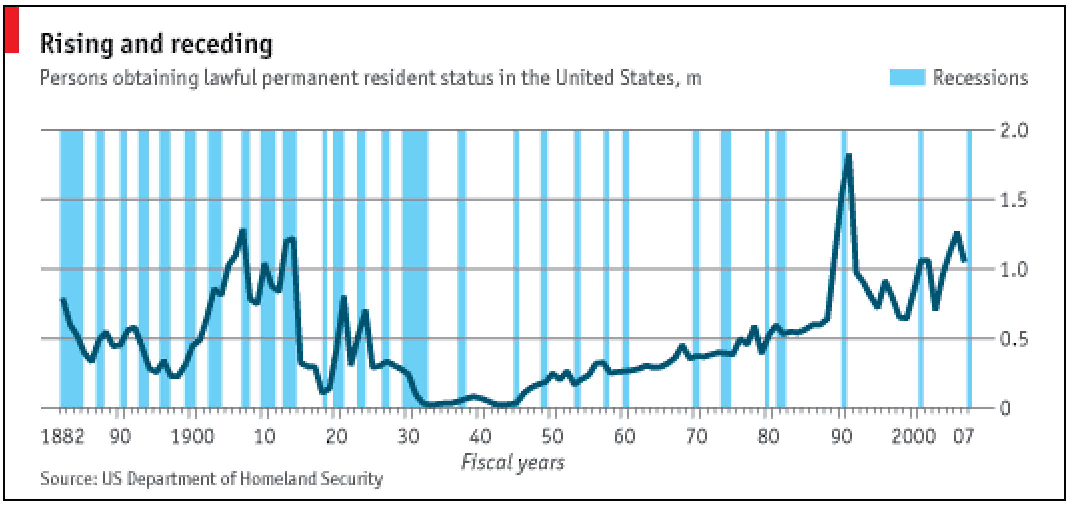
But as economic misery has spread to poorer countries, the picture has been muddied. Nobody knows what to expect from a co-ordinated global downturn at a time of historically high migration. Demetrios Papademetriou, one of the two authors of the MPI study, notes that as economies such as Mexico's are also battered, the push to export migrants could rise again fast. One estimate quoted by his study suggests that, if real wages in Mexico slip by 10%, American authorities should brace themselves for a 6.4-8.7% rise in attempted illegal immigration.

Similarly in Europe, although the economic slump has hastened the re-emigration of some from rich countries (anecdotes point to Polish workers leaving a sinking Iceland faster than rats off a ship), as economies in eastern Europe also slow, migrants may opt to stay. Young and single workers may choose to move on, but migrant families, especially, may conclude that they are better off claiming welfare in rich countries than returning home.

Lessons from history

A global slump is likely to change migration flows significantly. In October the UN secretary-general, Ban Ki-moon, urged rich countries not to put up barriers against migrants during a slump, but noted that "migration flows are reversing. In several instances we are seeing a net outflow from countries facing economic crises." The International Labour Organisation suggests that 20m jobs will be lost, globally, this year, and gives warning that the rich are bound to close doors.

The lessons from other big downturns suggest that migrants will suffer. Germany, France, the Netherlands and Belgium all called an abrupt halt to long-running guest-worker programmes in 1973, anticipating a painful recession that decade.



In the late 1920s and 1930s America, which had earlier seen very high rates of immigration, slammed its doors, and then kept immigration rates low for decades (see chart). As the Depression took hold, many foreign workers re-emigrated: some 500,000 left in the 1930s, with many southern Europeans moving back permanently to the old continent. In the same decade the stock of Mexicans in America fell by a dramatic 40%, as they lost jobs and many were deported. Similarly the depression of the 1890s provoked a host of migrant-hostile legislation in Argentina, America and elsewhere, as native-born workers demanded that foreign rivals be kept out.

The International Organisation for Migration (IOM), among others, now worries that once again xenophobia will rise as "job competition increases between nationals and migrants". Hostility is creeping up. Deportations from America are rising fast (a record 361,000 illegal migrants were kicked out in 2008, up from 319,000 the year before). An opinion poll by the German Marshall Fund, in November, suggested that a majority of Americans and Europeans regard migration as a problem, not as an opportunity.

Britons and Americans, in particular, are hostile to foreign workers, with over half of respondents saying that migrants steal jobs and roughly two-thirds saying that they bring higher taxes (because of claims on welfare). In turn politicians are talking even tougher about migration and, in some cases, such as Britain, are making it harder for outsiders to get legal entry.

Danny Sriskandarajah, until recently of the Institute for Public Policy Research in London, notes another concern about changing public moods. So far anxiety, for example in Britain, has been directed at the government for failing to control the influx of foreigners. "A more poisonous response is one targeted at the foreigners themselves," he suggests. That might come about as unemployment rises, especially if some migrants are better able than natives to keep jobs, for example in farm or care work, perhaps because of a willingness to work long hours for low pay.

Elsewhere hostility towards migrants is already becoming substantially more brutal. In Russia, human-rights groups fear that racist attacks against foreigners will soar as the economy slows. In December, as a gang of teenage skinheads was convicted in Moscow of killing 20 migrants, an NGO, Moscow Human Rights Bureau, reported that 113 migrants had been murdered between January and October 2008, nearly twice the rate of the year before. Some 340 migrants were also wounded.

Doomsters have other reasons to worry, especially about the poor. The past few years have shown how important remittances have become in alleviating poverty and spurring investment in poor countries. In some cases they account for bigger flows of capital than aid or foreign investment. They spread wealth from rich to poor countries, but now remittances are being squeezed.

In November the World Bank suggested that total remittances to poor countries last year would be at least $283 billion. Known flows have more than doubled since 2002 (partly a result of better measurement). For many small countries they accounted for a large chunk of GDP in 2007, for example in Tajikistan (46%), Moldova (38%) and Lebanon (24%). Choke remittances, and such places will suffer.

Even for larger economies, such as India and China, remittances provide hefty flows of capital. The World Bank expected India to get $30 billion from its diaspora in 2008 and China $27 billion.

The Philippines has some 8m people abroad: their remittances provide about a tenth of total domestic

output. In the first ten months of 2008 the country earned nearly $14 billion from emigrants, substantially more than the year before. But 2009 looks less rosy: the government is cutting high expectations of income from migrants, amid fears that Filipinos who work in IT and finance, especially, will lose jobs.

Elsewhere things are worse already. In November Kyrgyzstan lamented that remittances (mostly from migrants in Russia) were tumbling. Tracking such flows is hard, but an estimate by the central bank in Kenya—where migrant money is the biggest source of foreign currency, exceeding tourism—spoke of a sharp drop last year, especially from Kenyans in America.

Remittances had been seen as more resilient in an economic downturn than aid and investment flows, perhaps because the senders of cash have personal ties with the recipients. But the World Bank says some poor countries should expect "outright decline" in such funds. Flows to Africa, which had earlier boomed, stagnated last year; flows to parts of Latin America dropped. In November the head of the UN Conference on Trade and Development, Supachai Panitchpakdi, predicted that 2009 would see remittances to poor countries slide by 6%; but it could be worse.

A second reason to worry is that places with young, expanding populations have got used to exporting surplus labour. Morocco sends young men to Europe; Central Asian countries send them to Russia; Pakistan and other parts of South Asia pack them off to labour in the Gulf. If such exporters of humans can no longer do so, they will instead have to absorb millions more themselves: a tall order in a time of general downturn. The risk of social and political upheaval may grow.

From slowdown to spasm

A related spasm of social pain could be felt in China, where internal movement plays a big role in the economy. Some of the 140m domestic migrants (mostly rural folk who had gone to cities) risk losing their jobs. Officials know that finding ways to keep them working, or to provide them with welfare, will be essential. In December China's premier, Wen Jiabao, urged local governments to enact policies to create jobs "especially for migrant workers".

Is there a bright side from higher rates of migration? Optimists in Europe argue that enlargement of the EU and the freer movement of workers—some 2m east Europeans now live and work in western Europe—may give the continent useful flexibility during a recovery.

Late last year the European Commission suggested that young, well-educated workers will be prepared to move to find jobs. Around 80% of the recent arrivals from eastern Europe are younger than 35, and so are likely to be more mobile than their elders. The commission also suggests that relatively few countries (so far) have seen recent migrants make much use of welfare, beyond schools and clinics.

Unlike previous waves of migrants (like the South Asians who arrived in British factories in the 1950s), eastern Europeans can probably move between jobs. Poles, for example, may be well placed to move from construction to agricultural labour.

In America, too, migrants who are less reliant on welfare may be willing to move from state to state for work, or to opt for lower-skilled employment for the sake of sustaining their incomes. The bad news there, however, is that state crackdowns on unauthorised migrants, along with a border that is getting harder to cross, are making it tougher for migrant workers to flow to where they are needed. As barriers go up, migration's benefits go down.

Tracking freedom

It never stays long

Jan 15th 2009
From The Economist print edition

One survey shows liberty shrivelling; another names the "spoilers"

WHETHER your purpose is to promote freedom, to curb it, or to quibble about its definition, the reports of Freedom House, an American lobby group, make good reading. The new 2009 edition paints a sombre picture of how the world fared during George Bush's time in office. An initial five years of improvement were followed by a three-year decline—less in 2008 than previously, but still disappointing. Russia's rigged elections and cowed media attract particular criticism in the gloomy ex-Soviet section. Though Iraq posts a slightly better score, Afghanistan shifts from "partly free" to "not free" in Freedom House's broad three-category system. The Middle East and north Africa region—the centrepiece of Mr Bush's efforts to promote freedom—showed little measurable improvement over the previous year.

More widely, the number of "electoral democracies" (those with tolerably free and fair elections) dropped by two, to 119 (thanks to four demotions and two promotions). The general trend was down too, with declines in freedom of expression and association, and a weaker rule of law.

As with most international rankings, headline comparisons and trends are often less interesting than the details and the underlying thinking. Freedom House sticks to measuring the rise and fall of political freedom: it eschews the idea, promoted by outfits like Amnesty International, that economic and social rights matter equally.

Raw country-by-country figures can be misleading: the population-weighted results published by Freedom House are more informative. From that point of view, the failure of the Beijing Olympics to bring any of the promised (or more accurately, hoped-for) changes in China's policy towards dissent was probably the biggest disappointment of 2008.

A similarly heavyweight annual report from another American outfit, the New York-based Human Rights Watch (HRW), takes direct aim at what its director, Kenneth Roth, terms "spoilers". He writes: "Those conducting the most energetic diplomacy on human rights are likely to reside in such places as Algiers, Cairo or Islamabad, with backing from Beijing and Moscow. The problem is that they are pushing in the wrong direction." Such countries, he says, "hide behind the principles of sovereignty, non-interference and Southern solidarity, but their real aim is to curb criticism." He pointedly criticises the stance taken by India and South Africa, which uphold human rights at home but undermine international efforts against regimes such as Burma, Sudan or Zimbabwe.

At least in the eyes of the world, Freedom House and HRW come from slightly different places. The latter is adamant that it accepts no government funding, while the former does get money from the American taxpayer (and is committed to the view that American leadership is a good thing for liberty), though it has a decent track record of criticising the United States and its friends where appropriate.

In any case, the prospect of Barack Obama's presidency clearly delights HRW, which lambasts the "disastrous Bush years" for torture, secret prisons and "hyper-sovereignty" and hopes that America will now sign up for all kinds of international good causes, from landmine bans to the International Criminal Court. Freedom House is more cautious, praising Mr Bush for his championing of dissidents. It worries that the new administration will prefer improving relations with authoritarian countries to challenging them. Sadly, measuring government beastliness looks like a future-proofed business.

Technology firms in the recession

Here we go again

Jan 15th 2009
From The Economist print edition

It cannot defy gravity, but the technology industry is faring better than it did in the previous downturn

Illustration by David Simonds

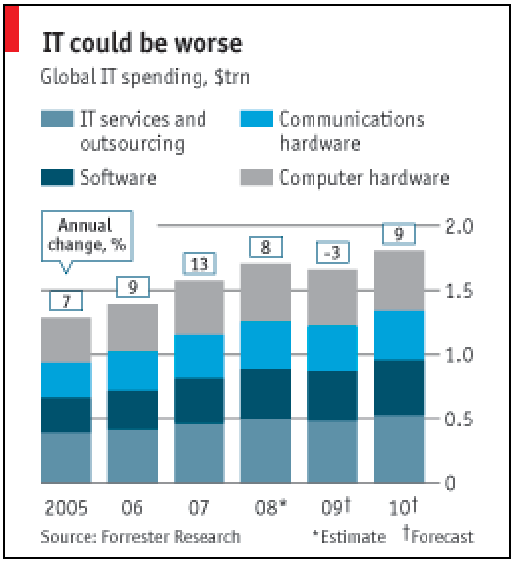
THE news may turn out to be no more than rumour, but it is telling nonetheless. To cut costs, several blogs recently reported, Microsoft and IBM would soon both get rid of about 16,000 employees each, 17% and 4% respectively of their workforces. If true, these would be some of the biggest cuts in the history of the information-technology (IT) industry.

That such cuts are deemed credible is a sign of the industry's plight. Hardly a day passes without reports of collapsing revenues and workers being laid off. This week Motorola said it would cut 4,000 jobs, and Seagate, a maker of hard disks, said it would reduce its staff by 800. The earnings season is likely to bring even more bad news. As *The Economist* went to press, Intel, the world's largest chipmaker and an industry bellwether, was expected to report a drop in fourth-quarter revenues of more than 20% compared with a year earlier. Is the industry heading for a worse downturn than the one that followed the internet crash in 2001?

That would be quite a feat. In America, for instance, technology spending grew by nearly 16% in 2000, only to contract by 6% in 2001. "The IT industry simply imploded," says Matt Asay, an industry veteran and executive of Alfresco, an open-source software firm. "It felt like the sector's reason for being had disappeared."

This time things are not yet that bad—and are unlikely to become so. In spite of the string of bad news, some forecasters still expect global IT spending to grow this year, at least when you allow for currency fluctuations. According to Forrester Research, a market-research firm, technology purchases will decline by 3% in 2009 when counted in dollars (see chart). But the dollar's relative strength weighs heavily on the results of American firms by devaluing their foreign revenues. When measured in a basket of

local currencies, weighted for each region's share of the global IT market, Andrew Bartels of Forrester expects an increase of 3%.



There are many reasons why spending is more robust than during the last downturn. For a start, the IT market has become more global. Between 2003 and 2008, developed countries' share of IT spending fell from 85% to 76%, according to the OECD's recently published Information Technology Outlook. Demand from China and India is expected to continue to grow despite the gloomy economic outlook.

More importantly, last time around the IT industry was not the victim of an economic crisis, but its cause, says Graham Vickery, author of the OECD report. For years companies had spent far too much on technology, buying more e-commerce software than they could ever hope to use, for example. When the bubble burst they abruptly cut spending. Today IT departments are much less prone to wasting money. In fact, says Mark Raskino of Gartner, another market-research firm, most are quite lean. Further cuts in technology budgets would be difficult, he argues, since they would require many firms to reorganise themselves first. "IT is certainly not sacrosanct, but fairly low on the list of things to cut," he says.

Tech firms, for their part, are in much better shape. Venture capitalists may again have wasted money by investing in too many internet start-ups, this time labelled "Web 2.0". But, in general, the industry's big companies are better managed and have more cash on hand. Heavyweights such as HP, IBM and Oracle are probably best placed to weather the storm, thanks to their broad product portfolios and international presence. Software and services will do better than hardware or semiconductors. Other relative winners will be technologies that promise quick savings, such as videoconferencing gear and "virtualisation" software, which allows firms to get more out of hardware they already own.

Still, the IT industry cannot defy gravity, says Brent Thill, an analyst at Citi Investment Research. And this recession could end up worse than the last if it drags on. In 2001 the crisis consisted of a collapse followed by a quick recovery, he says. Today looks like an inexorable march downward. Mr Thill sees it as ominous that in his latest survey of 200 chief information officers on both sides of the Atlantic, nearly half said they had not yet set their budget for 2009.

Yet even if the plot is different, the consequences are likely to be similar. In many ways the previous IT downturn marked the industry's coming of age. In its wake, the industry was no longer mainly about "hot" new technologies that made maximal use of Moore's law, which holds that roughly twice as much processing power is available at a given price every 18 months. Firms have since started to opt more for good-enough "cold" wares, which save them money and allow for more flexibility: commodity hardware, open-source software such as the Linux operating system and programs accessed over the internet, or "software as a service" (SaaS).

The crisis will only speed up this shift, not least because many of the cold technologies have themselves become more mature. SaaS and other computing services supplied online, and collectively called "cloud computing", have become better and more widespread. In November Salesforce.com, the largest SaaS firm, beat analysts' expectations, reporting sharply growing revenues and profits.

And open-source software has long since moved beyond Linux. All kinds of enterprise software is now available in this form, which in most cases means that firms pay for maintenance services, but that the programs are free. This business model already seems to be benefiting from the downturn. Revenues at Alfresco, which makes software that helps manage web content, for instance, have tripled in the last quarter, according to Mr Asay.

Will the industry therefore emerge selling commodity products? Actually, commoditisation and standardisation are creating new platforms for innovation. Cloud computing, for example, should allow small firms and even individuals to outsource computer management rather than doing it themselves—something that is only an option for big firms at present—and open up new opportunities for the industry by allowing it to reach into new fields.

The rapidly growing mobile internet gives a glimpse of what is to come. Only a year ago, downloading software to an iPhone or other "smart" mobile device was only for technophiles. Now it is commonplace. Over 300m applications, including games and utilities, have been downloaded from Apple's App Store

alone.

Were it not for the recession, says Gartner's Mr Raskino, the industry would actually be ready for another of its high-growth phases, which it tends to enter every eight years or so. Since IT investments are being held back now, he predicts, they will pick up quickly when the economy recovers, be it in 2010 or later. And given the industry's notoriously short memory, today's jitters will quickly be forgotten.

Nortel

The bigger they come

Jan 15th 2009
From The Economist print edition

Canada's technology icon is unlikely to emerge from bankruptcy protection

IN THE end the question was not if, but when. On January 14th Nortel, a troubled Canadian maker of telecoms equipment, filed for bankruptcy protection, making it the first big technology firm to succumb to the recession. "Nortel must be put on a sound financial footing once and for all," explained Mike Zafirovsky, its chief executive.

It marks the end of a breathtaking fall. Nortel, a high-flyer during the internet boom, was once Canada's largest company, employing 95,000 people worldwide and boasting a stockmarket value, at its peak, of C$366 billion ($251 billion), accounting for more than one-third of the value of the entire Toronto Stock Exchange. Just before the filing this week, its workforce had shrunk to 26,000 and its stockmarket capitalisation to a mere C$191m ($156m).

The immediate cause of Nortel's demise is the recession, which hit it particularly hard. In November Nortel posted a third-quarter loss of $3.4 billion. Revenue in its core business, which sells switching gear to telephone companies, fell by 24%. But the roots of Nortel's troubles go deeper. It never really recovered from the bursting of the internet bubble in 2000-2001, followed by an accounting scandal in 2004.

Will other big technology firms follow it into bankruptcy? Not necessarily. Although its rivals are not doing too well, they are stronger. In December Alcatel-Lucent said demand for its products would fall by 8-12% next year, and it would not make much of an operating profit before 2010. Even Motorola and Sun Microsystems, embattled makers of telecoms equipment and high-end computers respectively, should be able to make it through the recession, provided they are not taken over or broken up by their own management. Both firms have plenty of cash in the bank.

Still, Nortel could become a model. Its filing was a "strategic move", says Richard Windsor, an analyst at Nomura Securities. With $2.4 billion in the bank, Nortel could have limped along for a while. But it went for bankruptcy protection now, he says, so it would not have to do it in total desperation when the money had run out. Will it emerge in one piece? Probably not, says Mr Windsor. Its parts are likely to be sold, perhaps to Huawei Technologies, a Chinese rival which has been looking to boost its presence in North America for some time. It is a sorry end for a once-proud Canadian technology icon, but this way investors will at least get some of their money back.

Corporate finance

The great dilution

Jan 15th 2009 | NEW YORK
From The Economist print edition

Companies may be forced to follow banks' lead and tap their shareholders

IN 2008 battered banks scurried to raise fresh capital. As the recession bites, they will have to come back for more. Jostling with them for limited funds will be a fast-growing number of cash-strapped non-financial firms. Pain is spreading fast across the corporate world: analysts estimate that fourth-quarter profits across the S&P 500 fell by 15% year-on-year, the sixth decline in a row—the worst run on record. Days after laying off 13,500 and cutting production, Alcoa, a bellwether for earnings, announced a crushing $1.2 billion loss. Even traditionally defensive industries, such as pharmaceuticals, are suffering: Pfizer plans to lay off up to 8% of its researchers.

With banks loth to lend and credit markets still in turmoil, a tsunami of defaults seems imminent, despite the fact that credit has thawed a little in recent weeks: junk-bond spreads have fallen from their dizzying peak of 22 percentage points over government debt, and firms are paying less to issue commercial paper, widely used to finance working capital. But they will still struggle to roll over much of the $518 billion of corporate bonds and more than $1 trillion in loan facilities that, according to Citigroup, must be refinanced this year—especially given increased competition from sovereign borrowers seeking to plug deficits. Worse, a growing band of investors is using a mix of short-selling and credit-default swaps (CDSs) to bet against firms with heavy refinancing exposures. As their CDS spreads widen, those companies find it ever harder to sell fresh debt.

This could leave a lot of companies having to cough up big chunks of principal on top of their regular interest payments when bonds mature, just as revenues plummet. The debt-service coverage ratios (free cashflow divided by repayment obligations) of highly geared firms are falling below the critical level of one at a pace that seems to be unprecedented, says Barrie Wilkinson of Oliver Wyman, a consultancy. Cutting interest rates to the bone does little for firms that suddenly find themselves having to repay principal.

CDS spreads imply that around 10% of American firms will be forced into default. To avoid this, those that have trouble rolling over their debt have two main options. The first is to sell assets and use the proceeds to pay down debt. But losses booked from selling at fire-sale prices could quickly wipe through thin layers of equity. The second route is to raise capital, either through a debt-for-equity swap—as GMAC, a troubled vehicle-finance and mortgage lender, has done—or a discounted offering, such as a rights issue.

Some have already taken this last route to get lenders off their backs. Britain's Premier Foods, for instance, is planning a rights issue in exchange for banks loosening the terms of its debt covenants. Others are likely to follow. Andrew Smithers of Smithers & Co, a research firm, expects American companies to swing from being net buyers of their own equity (through buybacks) to net sellers. Mr Wilkinson predicts a "great dilution" of existing shareholders in 2009. This could drive another round of selling in stockmarkets, he argues, which have hitherto focused only on falling profits. Fear over the need for further capital-raising contributed to the decline of banks' shares.

Cash-poor firms would do well to move quickly. Banks that needed equity but dithered last year discovered to their cost that the pool of available capital was not limitless; they had to pay far more for it later, if they could get it at all. And stronger firms are drinking at the pool, too: Scottish & Southern, a British energy group, has just raised £479m ($704m), in part to bolster its ammunition for opportunistic deals.

As the problem grows, governments in America, Britain and Germany are starting to step in. But all this woe has a silver lining—at least for the investment bankers who have already been through it. The wave of corporate capital-raising will bring in underwriting fees that will help offset the slump in mergers and flotations. If they can find willing takers, that is.

Business in China

Not playing

Jan 15th 2009 | DONGGUAN
From The Economist print edition

Smart Union was everything a Chinese firm aspired to be, then nothing at all

IT HAD record sales last year and was widely considered to be one of the best companies in its field. But now Smart Union, a Chinese toymaker, is being dismembered through a provisional liquidation. Its story encapsulates the arc of China's economic success and recent downturn. The firm grew consistently for 12 years. Its orders, factories and employees steadily increased in number, and a web of suppliers grew up around it. But in October, at the peak of the pre-holiday production cycle, the entire process went into reverse, leading to the direct loss of 12,000 jobs, and the indirect loss of many more.

Tom Easton

The writing on the wall

Today the streets are silent around the two largest Smart Union facilities in Dongguan. Creditors have posted notices of legal claims on the factory walls. Occasionally someone stops by to staple on a new petition, or flip through the older pages that turn brittle within hours in the hot, dusty and polluted air.

Smart Union's founder, Tony Wu, was the child of two unskilled construction workers in Hong Kong. After receiving an engineering degree in 1978, he joined the toy industry, which was relocating from America, Europe and Japan and providing the foundation for southern China's industrialisation as it did so. He started off working in Hong Kong for Kenner, holder of the "Star Wars" licence, then moved with the industry to the mainland, first with Mattel, then Ertl, then Universal Matchbox and so on. In 1995, in classic Hong Kong style, he set up on his own.

At first he worked as a middleman, arranging production for the small, inexpensive promotional items given away by fast-food chains. Having saved enough to buy a shell company called Smart Union, he used it to acquire a tiny mainland factory in 1997. Smart Union quickly evolved from making cheap, injection-moulded figurines to toys with mechanical and then electronic parts. Its clients included Mattel, Hasbro and Disney. Within the clubby world of toy manufacturers, which stretches from the office blocks of east Tsim Sha Tsui in Hong Kong to the factories over the border, Smart Union was seen as one of the winners, a trusted manufacturer with none of the quality problems that came to terrify the buyers of Chinese products.

During 2006 a public offering on the Hong Kong Stock Exchange raised HK$53m ($7m) and the share price more than doubled over the next year. By the end of 2007, sales approached HK$1 billion, up 30% over 2006, making Smart Union a relatively large firm by local standards.

Even as it apparently enjoyed strong growth, however, problems were emerging. Profits, for example, were dropping, in part because of huge reinvestment to cover the expansion in sales, but also because China began to overheat in 2007. Every manufacturing-input cost rose, from electricity to petroleum (for plastics) to metals to wages. A new, costly, labour law came into effect. And the appreciation of the yuan

meant orders priced in dollars—the overwhelming majority—brought in less income. Big global retailers were unsympathetic, showing their own greater knowledge of Chinese manufacturing by driving ever tougher bargains with small producers that desperately needed orders.

None of these factors would have been fatal, but for an abrupt tightening of credit in early 2008 that, in effect, cut Smart Union's working capital in half. Sources of money that had been plentiful in 2007 dried up. In desperation the firm asked suppliers to be patient and buyers to accelerate payments, and raised costly loans from outside the banking system.

In June severe rain hit Dongguan. There were unconfirmed reports that local officials allowed dams to be opened, out of concern that they might not hold. Whatever the cause, a flood swept the city and Smart Union was badly hit. More than HK$65m in inventory was lost, along with a month of work. Piles of damaged goods still lie outside one of its factories. Rumours of an impending closure caused suppliers to pull back deliveries and workers to demand salaries in advance. "I learnt that without confidence, a business is dead," says Mr Wu. The firm essentially shut down in September, despite having a heavy backlog of orders.

After worker protests, the city government settled contract claims. The money should be recovered, Mr Wu believes, from insurance payments tied to the flooding, and the sale of the factory buildings. There is much anger and the firm's managers have been told not to return to China for their own safety. Mr Wu says he has been trying to petition the government, arguing that there was no fraud and that everything had been done to save the firm. Having built a respected business in China, he wants a second chance. In the meantime, finding himself out of work, he has started studying for a doctorate. His thesis subject? What a company needs in order to grow.

The Satyam scandal

Offshore inmates

Jan 15th 2009 | DELHI
From The Economist print edition

India struggles to get to grips with a bewildering corporate fraud

IN ANY software project, according to an industry adage, programmers think they are 90% done for about 50% of the time. That paradox will be familiar to the owners of Satyam Computer Services, which was once India’s fourth-biggest software and services firm. The scam perpetrated by its founder, B. Ramalinga Raju, and his brother is equally hard to fathom. On January 7th Mr Raju confessed to cooking Satyam’s books for years, and admitted that a $1 billion cash pile did not in fact exist.

AP

But were there hands in the till?

But when a liar confesses, can you believe him? Many suspect that even now only 50% of the truth is out. Cash, after all, is hard to fake. Satyam’s books were audited by PricewaterhouseCoopers. According to the *Economic Times*, an Indian newspaper, the auditor says it verified Satyam’s fixed deposits with the banks that held them. So perhaps the money did exist, but has since been spirited out of the company.

Such tricks are not unusual in India, even if the scale of the Satyam fraud is extraordinary. Indian “promoters” (who include business families and other corporate insiders) still hold almost half of the shares on the National Stock Exchange (NSE). But many family firms are evolving into widely held corporations. The danger is that as the stake held by insiders falls, they have an incentive to rip off other shareholders by siphoning off money.

Some of their favourite techniques were outlined in a report last month by Saurabh Mukherjea, who returned to India from Britain in May to scrutinise stocks for Noble, an investment bank. Managers might, for example, lend to a son’s firm, or overpay for a training weekend and take a cut from the hotelier. Manipulation of accounts in India is “ferocious”, says Mr Mukherjea, and not just by small firms.

Who will stand up for the minority shareholders? In America managers cower before pension funds and other powerful institutional investors. But India lacks a local equivalent. Its occupational pension funds hold assets worth 2.5 trillion rupees, only about 5% of GDP. They are permitted to invest only 15% of their holdings in shares, and actually invest even less.

Some hope that foreign investors might fill the gap. They hold about 10% of the shares on the NSE, more than Indian banks, insurance companies and mutual funds combined. They ought to be wary of inscrutable companies, giving the firms an incentive to change their ways. But foreign investors can only take big positions in the firms they buy. And since half of India’s shares are held by promoters, a foreign fund cannot take a worthwhile position without managers’ acquiescence. So funds are reluctant “to cheese off management too much” by complaining about corporate governance, says Mr Mukherjea.

That complacency has been shattered. Indeed, in the wake of the Satyam scandal, investors have been swift to punish even small infractions. The shares of Wipro, another computing giant, fell by 9% on January 12th after the World Bank revealed it had barred the firm from doing business with it until 2011. Wipro’s transgression was to invite bank officials to take part in an oversubscribed share offering in 2000. Many who did so lost money. “It is a real debate whether it was a benefit at all,” says Suresh Senapaty,

Wipro's finance chief.

Meanwhile Mr Raju, his brother, and Satyam's chief financial officer are in custody, charged with criminal conspiracy, cheating and forgery. Satyam is in the hands of three directors appointed by the government. If they do not act swiftly, Satyam's rivals may pick up its most lucrative customers and its best employees. But right now all that its Indian competitors want from Satyam is distance.

Apple

Lost Jobs

Jan 15th 2009 | SAN FRANCISCO
From The Economist print edition

Steve Jobs steps down

ON JANUARY 5th Steve Jobs, the revered and controversial boss of Apple, disclosed that "a hormone imbalance" had been "robbing" him of proteins all last year, which was why he has appeared so gaunt. He insisted that the cure would be "simple and straightforward" and declared defiantly that this was "all that I am going to say about this."

But on January 14th he had to say more: "I have learned that my health-related issues are more complex than I originally thought." He announced that he was taking medical leave until June, during which time his number two, Tim Cook, would run Apple. "I look forward to seeing all of you this summer," Mr Jobs ended his latest letter to his firm's employees. But there is a real possibility that Mr Jobs, who had surgery for a rare form of pancreatic cancer in 2004, will not come back.

And so the era of Steve Jobs at Apple may already have ended. Investors, customers, employees and fans have barely begun to absorb the consequences. No boss today embodies and defines his company as completely as Steve Jobs. "I don't see an Apple, the way we would define the company, without Steve," says Mark Anderson of Strategic News Service, a technology think-tank.

Two separate dramas will now begin playing out. One is the unfolding of Mr Jobs's personal story. He founded the company with a friend in the 1970s. He pioneered the era of the personal computer in the 1980s. He was thrown out of the company in a boardroom coup in 1985. He spent 12 years remaking himself, then returned to lead the then-struggling firm to its greatest triumphs: the iMac, which reinvigorated its computer business; the iPod, which has transformed music; and the iPhone, which has shaken up the mobile-phone industry.

The other drama is the unfolding of Apple's story. The closest to a successor that the company has is Mr Cook, who is chief operating officer and briefly ran Apple while Mr Jobs was having his cancer surgery. Mr Cook keeps a very low profile, as Mr Jobs prefers his staff to do. He is single and a workaholic. He has a southern drawl and is as cool as Mr Jobs runs hot. He is the master of Apple's operational minutiae. But not a single gesture by him or Mr Jobs has ever suggested that he might become the permanent chief executive.

To take his own place on a stage this month, Mr Jobs instead chose Apple's marketing boss, Philip Schiller. Mr Schiller put on a gamely performance, but in subtle ways the absence of Mr Jobs, a consummate showman, was felt throughout. Mr Jobs likes to tease audiences toward the end of speeches with "one more thing"; Mr Schiller, as though emphasising that he was not trying to replace Mr Jobs, turned it into "one last thing".

It is unknown whether Apple has a pipeline of innovative new products on the scale of the iPod or iPhone. A tablet-like device to contest Amazon in electronic-book readers, or an internet-capable television set, is possible. A new line of laptops has just been announced.

But the real question for Apple is whether the person of Mr Jobs is the glue that holds the talent underneath him together. Apple's magic is part design, part engineering, part logistics and part vision. Design is the domain of Jonathan Ive, a shy Briton; engineering is split into hardware and software; logistics is run by Mr Cook. And the vision thing belongs entirely to Mr Job. Without him, will all the other pieces, and the magic, come unglued?

The car industry

Bright sparks

Jan 15th 2009 | DETROIT
From The Economist print edition

Electric propulsion provides some excitement amid the gloom

THE sombre mood at this year's Detroit motor show manifested itself most visibly in the austerity of the exhibitors' displays, and Chrysler's in particular. Over the years the smallest of America's Big Three manufacturers has introduced new models by driving a sport-utility vehicle through the plate-glass windows of the Cobo Hall, dropping a pickup from the roof and firing a minivan through the air. But having just received a life-saving government bail-out, Chrysler did not want to appear extravagant. Gone were the over-the-top stunts and computer-controlled fountains. Instead it opted for a simple exhibit that resembled a giant showroom.

EPA

A beacon in the darkness

General Motors (GM), the recipient of its own bail-out, also opted for the corporate hair shirt. Ford, the strongest of the Big Three, was careful not to appear too flashy. And even the Japanese carmakers, wary of reviving protectionist sentiments, took a low-key approach. Only the Germans were in a party mood. Some carmakers, including Nissan, Land Rover and Porsche, did not attend the show at all—understandably, given the collapse of America's car market during 2008.

One of the few bright spots amid the gloom was the nearly universal enthusiasm for hybrid and electric vehicles. Almost every maker had a hybrid or all-electric car on display, and the word "electrification" was on everyone's lips. A disproportionate number of the new vehicles unveiled at the show relied on some form of electric propulsion, with carmakers as diverse as GM, Mercedes-Benz, Toyota and China's BYD pulling the wraps off an assortment of hybrids, plug-ins and all-electric vehicles.

Most anticipated was the introduction of the newest version of Toyota's Prius (pictured), the world's bestselling hybrid car. It is slightly more aerodynamic than its predecessor and has several nifty new options, including a ventilation system powered by solar panels on the roof. But one feature it still lacks is a plug for recharging: Toyota says battery technology must improve further before it launches a "plug-in" Prius, capable of making local trips on battery-power alone and recharging from the mains. For its part, GM showed the "production ready" version of the Chevrolet Volt, its plug-in hybrid, due in 2010.

A 50% fall in American sales of hybrid cars in the final months of 2008, as the price of petrol fell along with the oil price, took some of the shine off the new Prius. Cars for which there were waiting lists only a year ago are being offered at a discount, and Toyota has delayed the opening of a new Prius factory in America. But many in the industry think it is only a matter of time before petrol prices rise again, and that electric propulsion is the future.

Beyond hybrids, several all-electric vehicles were on display in Detroit, both from well known makers such as Mercedes-Benz, with its Blue Zero E-Cell concept car, and also from ambitious newcomers such as

Tesla Motors, based in Silicon Valley, and BYD, a Chinese battery-maker that has branched out into electric cars in recent years. Most makers talk of battery packs that take up to eight hours to charge and provide a range of around 100 miles, but BYD claims its “lithium ferrous phosphate” battery technology can provide a range of 250 miles with as little as three hours of charging.

Furthermore, BYD says its batteries cost roughly half as much as rival lithium-based designs. Elon Musk, the founder of Tesla, is sceptical: “No bloody way,” he says. But BYD is enticing enough for Warren Buffett to have invested $230m for a 10% stake in the Chinese firm. The legendary investor, at least, is convinced.

Face value

One tough Yahoo!

Jan 15th 2009
From The Economist print edition

Life has tested Carol Bartz far more than even running Yahoo! will

Reuters

WHO is Carol Bartz? This week Yahoo!, a huge but floundering internet company, appointed her as its new boss. Ms Bartz is one of only a few women at the top in Silicon Valley, now that the female bosses of Hewlett-Packard and eBay have departed. She is also a weathered Valley veteran. She ran Autodesk, a software company based just north of San Francisco, for many years. She sits on the boards of technology giants such as Cisco and Intel; she used to work at Sun Microsystems and DEC; and she has a nice house and garden in Atherton, the Valley's swankiest suburb. A very safe choice, it would seem.

Too safe, some say. Ms Bartz, at 60, is strikingly old to be running a "Web 2.0" company that, along with Google and Facebook and the rest, needs street cred among college-age kids like Ms Bartz's own daughter, Layne. The first computer that Ms Bartz touched was a punched-paper-tape IBM 1620 in 1967, the sort that Yahoo!'s programmers today might have read about in the palaeontology module of their computer-science curriculum.

Then there is the matter of her experience. Autodesk is a successful but smaller company (about half the size of Yahoo!) that sells software to architects and engineers to help them visualise underground sewers, skyscrapers or aeroplanes in three dimensions. This has nothing whatsoever to do with consumer e-mail, web search or financial news, with online advertising or page views—in short, with Yahoo!.

Ms Bartz takes over from Jerry Yang, Yahoo!'s co-founder, who stepped in as chief executive in June 2007 when Yahoo! was already in crisis. Mr Yang made things worse by rebuffing Microsoft, which wanted to buy Yahoo! last year for $33 a share, a valuation that now evokes nostalgia (its shares are trading around $12). Mr Yang will return to his previous role of "chief Yahoo" and will remain on the board; his number two, Susan Decker, having been passed over for the top job, will depart. The well-connected Ms Bartz knows Mr Yang, since they both sit on Cisco's board. Might she be so close to Mr Yang that she will not want to risk offending him by putting Yahoo! through the wrenching pain it needs?

In fact, none of this reveals much about Ms Bartz as a leader, nor about the real reason why Yahoo!'s board chose her. Her main qualification is that Ms Bartz has been tested in life as few people in Silicon Valley have. Her trials have turned her into a hardened, disciplined, occasionally ruthless, but often inspiring boss—exactly the sort of leader, it could be argued, that Yahoo! now desperately needs.

She was born in Minnesota but lost her mother when she was a child, so her grandmother raised her in a small town in Wisconsin. This early setback appears to have left Ms Bartz with insecurities that would forever motivate her to achieve. She became a homecoming queen and a mathematics star in high

school. She worked her way through college by serving cocktails, maintaining a Spartan exercise regime in order to fit into the uniform—a red miniskirt and black fishnet stockings.

Ms Bartz then went to work at 3M, one of America's blue-chip companies, in the 1970s. But when she requested a transfer to headquarters, she was told that "Women don't do these jobs." She walked straight out of 3M and into the computer industry. Eventually this led to her big break, when she was appointed chief executive of Autodesk. But there was a catch.

Just as she began her new job, Ms Bartz was diagnosed with breast cancer. She was 43 at the time, and decided to fight on all fronts. She took a single month off work for a mastectomy and reconstruction, and then went back to her new job full-time, while having chemotherapy for seven months on the side. She defeated her cancer, gained weight and lost it again, and launched Autodesk into a period of astonishing growth.

Her discipline was iron—and possibly excessive. To keep her family in Atherton, she commuted to the office, which required a long, traffic-clogged drive across the Golden Gate Bridge. To regain these lost hours each day, she spent the whole time behind her chauffeur reading and working, often stopping several times along the way to throw up out of carsickness. Her driver knew all the best places to pull over along Highway 101.

Secateurs at the ready

All of which exemplifies Ms Bartz's general approach to "work-life balance". To Ms Bartz the very notion is nonsense. You can "have it all", as she does, but only by cutting life into compartments and then ruthlessly maintaining the boundaries. When her daughter, whom she had at 40, was a baby, Ms Bartz spent three days a week looking after her at home in Dallas, where she was living at the time. On Mondays she handed the baby to her nanny and flew to Silicon Valley for four days of work; then she flew home again at midnight on Thursdays.

Unlike a lot of men in her position, Ms Bartz kept her power in perspective. She had groomed a successor at Autodesk and became worried that he might leave if she stuck around too long. So she made way for him and became Autodesk's chairman. "There is a real difference between managing and leading," she once said. "Managing winds up being the allocation of resources against tasks. Leadership focuses on people. My definition of a leader is someone who helps people succeed."

How, then, is she likely to make Yahoo! succeed? It is hard to imagine her trying to be geekier than the Young Turks at Google, Yahoo!'s larger and far more successful rival. Instead, she may approach Yahoo! as she does her life, or her garden in Atherton, stuffed at various times with everything from heirloom tomatoes to bearded irises. "If you don't kill a lot of plants along the way, you don't know how to garden," she once said. In short, if there is one person tough and unsentimental enough to disassemble Yahoo!, sell parts of it to Microsoft and merge others with some media company, it is Carol Bartz.

The car industry

The big chill

Jan 15th 2009
From The Economist print edition

Car sales around the world dried up in the last quarter of 2008. What are the prospects for an industry so reliant on credit and consumer confidence?

Bloomberg News

THE symbolism of the freezing temperatures in Detroit this week was lost on no one. The mood at the annual motor show was sombre, the razzmatazz noticeable only by its absence. Nobody needed reminding that General Motors (GM), normally the dominant exhibitor and until recently the world's biggest carmaker, would be in the bankruptcy courts but for emergency federal loans just before Christmas. GM's plight is only the most dramatic expression of the bleak state of the global car industry. Sales figures published the week before the show confirmed what everyone already knew: the second half of 2008 saw the most savage contraction of demand since the modern industry was formed after the second world war.

No company or country has been immune from the collapse. Last month sales of cars and light trucks in America fell by 35.5% compared with a year ago (see chart 1). In France, despite government incentives designed to prop up the market, sales were down by 16%; in Spain they fell by almost half; in Japan by 22.3%. Even in Brazil and China years of double-digit growth turned into sharp declines in the last quarter of 2008.

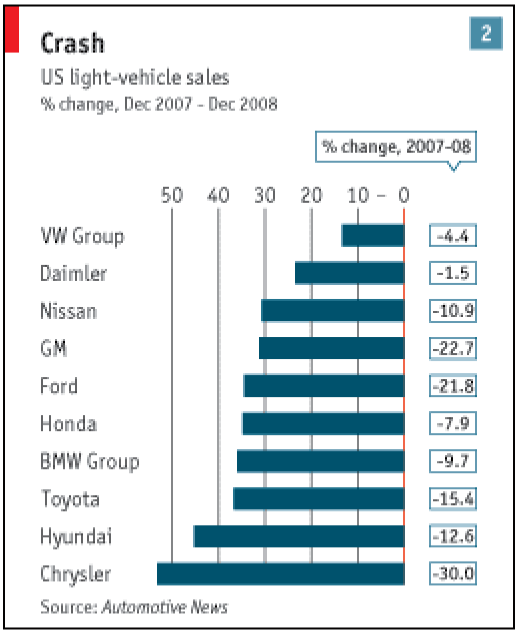
The woes of Detroit's Big Three carmakers have received most attention because of the toxic cocktail of factors that has made them especially vulnerable. They relied too much on mammoth pickup trucks and SUVs, which no one wanted when petrol prices hit $4 a gallon. Their finances were already strained after years of restructuring. And they were the most exposed to the American market, which was hit first and hardest by the financial crisis.

Beyond Detroit

But in the past few months the agony has spread to just about every other leading firm. Judged by American sales over the whole of last year, the Big Three suffered most. Ford and GM dropped by more

than 20% in 2008, and Chrysler by 30%. Toyota, number two in the market, fell by 15%; Hyundai, Nissan and especially Honda (down by 8%) did a little better. However, the year-on-year figures for December show that the pain was more evenly distributed by the end of the year (see chart 2). Except for Chrysler, where sales dived by 53%, almost all the big carmakers suffered percentage declines in the low to mid-30s. Toyota and even Honda did slightly worse than both GM and Ford, which may have discounted prices more heavily in the run-up to Christmas.

Prestigious brands have been clobbered as much as volume manufacturers. BMW's American sales fell by 40% in the year to December and those of Mercedes by 32%. Rolls-Royce, whose customers might be thought impervious to hard times, sold 29 cars in December 2007, but precisely none last month.



The cause is no mystery. It all began more than a year ago in America with the subprime-lending crisis and then the doubling of oil prices. Buyers with below average credit ratings found it increasingly hard to borrow to buy cars, new or used. Dearer pump prices set off a scramble to swap gas-guzzlers for smaller vehicles, which in turn led to a collapse of residual values. By the second half of 2008 the contagion of tightening credit and waning consumer confidence was spreading to other mature markets in Europe and Japan. Even the BRICs (Brazil, Russia, India and China), the great hope of the global car industry, slowed from a sprint to a limp.

However, the real trouble came only in November, in the financial meltdown begun by the failure of Lehman Brothers. As the credit system seized up and stockmarkets panicked, global car sales buckled. According to different estimates, the volume of world car sales in November fell by between 20% and 24%. Nigel Griffiths, the head of automotive forecasting at Global Insight, describes the "highly synchronised nature" of the collapse in light-vehicle sales at the end of 2008 as "completely without precedent".

That view is shared by Sergio Marchionne, the blunt-speaking architect of the near-miraculous revival of Fiat. In an interview last month with *Automotive News Europe*, he declared: "What we are seeing is unprecedented. I have never seen the failure of so many systems at once." Asked for his sales forecasts for 2009 and 2010, Mr Marchionne, who has a reputation with analysts for keeping his promises, confessed: "I honestly do not know. It's not that I refuse to make a projection. I just don't have a reliable context in which to make the projection…I abstain."

Mr Marchionne can at least be thankful that Fiat (except Ferrari and Maserati) is not exposed to the American bloodbath and is in its strongest financial condition for many years. Nonetheless, he makes no bones about the priority for the coming year: survival. He says: "We're just going to slam the brakes on, use as many temporary lay-offs as needed, cut everything back to essentials. It's like going swimming but never knowing if you can stand up because the bottom is so unstable you simply can't tell when you have reached it."

Almost every carmaker has a similar plan. Toyota, the world's biggest and most profitable, expects its first-ever operating loss in the financial year that ends in March. It said on January 6th that it would cease production for 11 days in February and March at all 12 of its factories in Japan, and that it would sack half its temporary workers and negotiate wage cuts with permanent staff. It had already decided to halt work for three days this month and to reduce output by 27%. GM and Ford have cut back by a similar amount.

Across the world carmakers are mothballing factories and dropping shifts. They are postponing or aborting the launches of new models. They are offering huge (and unaffordable) incentives to lure bargain-hunters into empty showrooms. But even these drastic measures may not be enough to save large parts of the industry.

The reason is chronic overcapacity, exacerbated by a recent binge of factory-building. CSM Worldwide, an automotive-market consultancy, estimates that the world could produce about 94m cars a year—about 34m more than it is buying. In North America alone, capacity exceeds demand by around 7m vehicles. In the seemingly insatiable BRICs, the lag between the burgeoning demand of the past few years and the

investment to meet it means that dozens of new factories are coming on stream at precisely the wrong moment.

Struggling with closed credit markets and insupportable operational gearing, carmakers are going cap-in-hand to governments to plead for loans to get them through the next few months. Some, such as GM and Chrysler in America and possibly Jaguar Land Rover in Britain (bought last year from Ford by Tata Motors of India), need state loans just to stay in business; others are demanding money to stave off the permanent closure of factories. Nearly all are urging governments to provide them with the cash to allow them to carry on lending to customers.

Liquidity and lubrication

How much of the downturn in sales can be attributed directly to the freezing of credit is hard to say. But credit is the lifeblood of the car business. More than two out of three sales in Europe are credit-financed. In America more than 90% of new cars are bought with some form of financing. For most customers, no credit means no new car.

Credit is the carmakers' most potent marketing tool. Finance is made available to dealers to ensure they hold adequate inventories and to give them an incentive to "move the metal" (support is withdrawn for cars that remain unsold for too long). It also allows them to offer loans at low interest rates or leases on attractive terms, perhaps packaged with insurance or maintenance. Cheap finance is often a better tool for carmakers than a straight rebate on the purchase cost would be, because it helps maintain both the prices of new cars and residual values.

What has made the credit crunch so painful for carmakers is the almost total dependence of their captive financial-services subsidiaries on wholesale funding, which has become scarce and expensive. In May Daimler's finance arm paid 5% on a bond issue; in December it had to pay 9%. Late last month GMAC (attached to GM) received $6 billion from the American Treasury's Troubled Asset Relief Programme; almost at once GM and its dealers offered 0% interest on five 2008 models and relaxed their lending criteria.

State backing can help for a while, but unless other sources of funding reopen soon, the future will remain grim. According to Exane BNP Paribas, the five largest European captive finance businesses will need to raise €10 billion ($13 billion) in medium- to long-term debt this year. They will also have to absorb rising losses on bad loans to customers and dealers, as well as the cost of returned lease cars that are now worth far less than once assumed.

All the signs are that governments in Europe as well as the new administration in Washington will help their national carmakers—at a price. The president of France, Nicolas Sarkozy, has made it clear that support for PSA Peugeot-Citroën and Renault will depend on production staying in the country. Other governments are likely to impose similar conditions. However, because of their relative financial strength, European and Asian car firms will be better placed than the Big Three to resist political interference in the running of their businesses once the crisis is over.

That is why Ford is still hoping (with some prospect of success) to get through the year without having to ask for a handout. It has indicated it would like access to a $9 billion short-term credit line if there is no improvement in the market during the second half of the year, but it is desperate to avoid being cast as a basket case as GM and Chrysler have been.

Of all the 11 big volume carmakers, Chrysler is the most likely to disappear this year. Customers are deserting it in droves; its product quality, according to the latest *Consumer Reports* survey, is so far below its competitors' that the magazine could not recommend any of its vehicles; its pipeline of new models is almost empty; unlike Ford and GM, which have successful foreign subsidiaries, it is almost entirely reliant on the brutal North American market; and its majority owner, Cerberus Capital Management, would love to be shot of it. The best that Chrysler can achieve with the $4 billion lent to it by the federal government is either to engineer an orderly bankruptcy or to attract a bottom-feeding buyer by dressing up the bits that could be sold—the Jeep brand and possibly Chrysler and Dodge minivans.

GM's position is more complicated and will prove a test for the new administration and Congress. For a start, it is bigger than Chrysler: so big, indeed, that its failure could bring down hundreds of parts suppliers on which Ford and the Asian "transplants"—Toyota, Honda and Hyundai—also depend. That

almost systemic risk to America's light-vehicle industry persuaded the reluctant Bush administration to stump up $13.4 billion to keep GM going until Barack Obama's team decides what to do with it.

GM, unlike Chrysler, contains a profitable business struggling to get out. Its products have been improving rapidly and it has the technological resources to be a leader in low-emission powertrains. The Chevrolet Volt, a plug-in hybrid, is due to be launched next year. Despite its difficulties at home, it is strong in most big markets abroad, especially China, which within a few years will be the world's largest.

That said, GM has well-known problems: too much debt, too many dealers and brands, high labour costs, and crippling liabilities to pensioners. In its plea for bail-out funds last month, the company promised to shed up to 31,000 jobs, close nine plants and renegotiate a four-year labour contract which it signed with the United Auto Workers (UAW) in 2007. GM also wants to close 1,750 dealerships, possibly eliminate its Saturn brand and convince banks and bondholders to swap two-thirds of its debt for equity. Under the terms of the loan, GM must show that all this is in place by February 17th to qualify for the final $4 billion payment. Unless the Obama administration is more sympathetic than its predecessor, GM must win the approval of its stakeholders by March 31st or be forced into repayment of the loans and certain bankruptcy.

If GM misses the deadline—possible, given displays of reckless brinkmanship by the parties involved—or scrambles over the line but still needs more money to stay in business, it will be at the mercy of congressional Democrats who would like to make it an instrument of their environmental agenda. Nothing would damage its long-term prospects more than being forced by politicians to build cars for which the market is not yet ready. If Congress wants GM to make more fuel-efficient cars it has a far better remedy at hand: raising taxes on petrol, which is once again absurdly cheap.

Whatever happens to GM, the effects will be felt throughout the industry. Its competitors may fear its demise; but a weaker, smaller GM, which looks the likely outcome, would suit them just fine. Toyota, with its $50 billion pile of cash and marketable assets and its huge manufacturing presence in North America, stands to gain most. It has the financial strength to keep factories ticking over until the upturn, and a management culture that is comfortable playing a long game.

Honda would benefit too. It has won a lot of market share in the past couple of years, thanks to its bestselling Accord sedan and its economical small cars. So, perhaps more surprisingly, would Ford, which ranks third in America, just ahead of Honda (and behind GM and Toyota). If it can get through this year as the only indigenous carmaker not to need a bail-out, it will be well placed to appeal to patriotic buyers when demand picks up. It also stands to gain from whatever concessions GM can wring from the UAW.

Looming in the rear-view mirror

Among European carmakers, the Volkswagen (VW) Group, which includes Audi, Seat and Skoda, is best placed to emerge stronger from whatever horrors the next 12-18 months have in store. Last year it overtook Ford to become the world's third-biggest producer, and a shrinking GM may feel VW's breath on its collar before long.

VW boasts excellent products in every segment. It has unrivalled strength in emerging markets, especially China, where its market share through two joint ventures is 18%, and Brazil, where it has a market share of 24%. It has the fastest-growing premium brand, Audi, which broke through the 1m sales mark in 2008. And it plans to expand fast in the United States, tripling sales by 2018, thanks to several new America-only models that will be the first VWs to be built in the country for more than 20 years.

AFP

Even the extraordinary takeover of the group by Porsche could turn out to be a help. The two managements appear to have reconciled their differences, and the addition of Porsche to the group's stable of luxury and sporting brands will bring scale economies in developing the technologies needed to make such vehicles environmentally acceptable. That may give them an edge over their German rivals, BMW and Mercedes.

For those two firms, the next couple of years are likely to be difficult. Their eager pursuit of lease sales in America and Britain has left them highly exposed to tumbling residual values. Between them, they have already written off more than €1.5 billion on lease returns, with more

to come. They must also spend a lot on developing fuel-efficient models to meet European Union emissions rules that come into force in 2015, without sacrificing the performance their drivers expect.


D is for Doomsday

Among Europe’s volume producers, Renault is suffering not just from the extreme market conditions, but also from the cool reception for new models such as the Laguna and the Megane. And unlike PSA Peugeot-Citroën and Fiat, it is exposed to the bombed-out American market through its 44.4% shareholding in Nissan. Fiat has rediscovered the happy knack of making money from building the kind of small cars that are right for the times, but it is far too reliant on Brazil, which accounts for over 50% of its operating profit. Mr Marchionne sees the danger all too clearly, not just for Fiat, but for the whole industry.

He believes that to have any chance of making money in the future, volume manufacturers will need to produce at least 5.5m cars a year (Fiat, he admits, is not even halfway there). The only answer, he thinks, is rapid consolidation. “Our strategy of industrial alliances was a step to get there. But given where demand is now and what we see going forward, it is too slow.”

Many will quarrel with Mr Marchionne’s view that in two years’ time there may be room for only six global mass producers. But it is hard to argue with his contention that only the biggest firms can afford the €500m cost of a new car platform. Mr Marchionne says: “We need to bring people round the table and say, ‘Look guys, the party is over. Someone called our bluff and we’re not all going to make it, so let’s fix it.’” Unfortunately, the sad spectacle of GM is a sign that, these days, even size is no guarantee of survival.

Citigroup

A house built on Sandy

Jan 15th 2009
From The Economist print edition

And the rain descended, and the floods came, and the winds blew, and beat upon that house; and it fell: and great was the fall of it

Illustration by S. Kambayashi

"TOO big to fail, too shit to buy" is the way some Citigroup insiders describe their employer. Not for much longer. On January 13th Citigroup announced that it had reached a deal to spin out Smith Barney, its broking arm, into a joint venture with Morgan Stanley's broker. The agreement presages even more dramatic changes. The bank has brought forward its fourth-quarter results to January 16th and expectations are high that Vikram Pandit, Citi's chief executive, will unveil plans to slim the bank further and faster.

The Smith Barney deal is already a watershed. As recently as November, Mr Pandit heaped praise on the broker and said he did not want to sell it. No wonder. Citi's wealth-management business, of which Smith Barney is a big part, was the only one of its main divisions to post a profit in the third quarter. And it sat snugly with Citi's universal-bank model, endorsed by Mr Pandit just weeks ago, of offering a full array of services to customers.

Citi will still receive its share of revenue from the joint venture, which overtakes the troubled Bank of America-Merrill Lynch combination as the world's largest broker by number of advisers, but there is no question who will be in charge. Morgan Stanley is paying Citi $2.7 billion to take a 51% stake in the venture, which will be called Morgan Stanley Smith Barney, and has an option to take further stakes. James Gorman, now seen as favourite eventually to succeed John Mack as Morgan Stanley's boss, will be the venture's chairman.

Mr Pandit's about-face reflects Citi's continuing need for capital. Those quarterly results are expected to be the fifth in a row where Citi bosses own up to a loss. Although the bank has received two shots of government money and has a decent level of capital by some measures, its first line of defence, common equity, is thin. Mounting problems in its consumer and corporate loans, as well as some old wounds in its portfolio of mortgage-backed securities, threaten to erode it further. Selling Smith Barney, which creates tangible common equity of approximately $6.5 billion, is the quickest way of plugging the gap.

Gap-plugging alone does not constitute a strategy. Initial word of the deal sent Citi's share price skidding

on January 12th, as investors reasoned that the bank must be desperate if it was choosing to sell one of its best assets. Hence reports that more radical surgery is coming, with up to one-third of the bank's assets being hived off to leave a slimmer Citi, focused on global corporate and retail banking.

Precisely what Mr Pandit has in mind is not clear, but it may be too late for an elegant retreat. Many of the businesses he would like to unload, such as Primerica, a seller of insurance, have been on the chopping-block for a while. Appetite will probably be keenest for the things that Citi would most like to keep—its retail-banking operations in Mexico and South Korea, say, or its suddenly sexy transaction-processing business. There is talk of setting up a separate entity to house the assets earmarked for sale, which could then be divested later. But that would still leave Citi with the problem of how to fill today's holes in its capital.

Citi's burst of activity signals two big, and necessary, shifts in thinking. The first is the final abandonment of the idea that has animated Citigroup since Sandy Weill engineered the merger of his company, Travelers, with Citicorp in 1998—that of the financial supermarket. The news on January 9th that Robert Rubin, a powerful voice in favour of the universal model, is to quit the board affirms the change. (The position of Sir Win Bischoff, the bank's chairman, is also reportedly under discussion; Mr Pandit looks more secure, if only because no one wants his job.)

Not super at all

Universal banking need not fail. But smaller, focused organisations are easier to run than large, sprawling ones—Citigroup has more employees than the American navy and, apparently, greater destructive power. Mr Weill's creation, backed by a host of executives, directors and investors ever since, has proved horribly flawed. Unlike HSBC, another giant, Citi has been built through deal making and it shows. Acquisitions were poorly integrated. Cultures overlapped rather than melded (the resilience of the Smith Barney name is one telling indicator). Risk management was dismal. The big balance-sheet was deployed recklessly. It may be inevitable that some banks are too big to fail; but the lesson of Citi is that they can also be too big to manage.

The second shift in thinking signalled by Citi's manoeuvres concerns policy. November's dramatic government intervention may have quelled fears that the bank would go under. But it has not stopped the bleeding at Citi, which remains focused on survival rather than on ramping up credit. Red ink laps around a host of other banks too. Full-year earnings at American banks are likely to be awful. Many eyes are on Bank of America, whose levels of tangible equity are also thin and, with Merrill Lynch and Countrywide to digest, is seeking billions of dollars in additional capital from the government. In Europe Deutsche Bank revealed a fourth-quarter loss of €4.8 billion ($6.3 billion) on January 14th, thanks in part to misplaced trading bets.

Recognition is growing that bad assets must somehow be purged from banks' balance-sheets before they will freely make new loans. Citi has already had more than $300 billion of toxic assets ringfenced and guaranteed by the government; its apparent intention to create a separate entity for its unwanted assets is a more straightforward echo of the "good bank/bad bank" approach used in Sweden's much-vaunted bail-out of the 1990s. In a speech on January 13th Ben Bernanke, chairman of the Federal Reserve, pointedly highlighted the continuing need for the financial system to shed its toxic assets.

That was the original purpose of the $700 billion Troubled Asset Relief Programme (TARP), approved in October, an effort that largely foundered on the difficulties of setting a purchase price for bad assets. The valuation problem has not gone away. Given the further deterioration in markets since the autumn, few believe that the $350 billion still left to spend from the TARP, if Congress agrees to release it, is anywhere near enough to absorb all the poison in the system. Even so, Citi's shift in direction may signal that policymakers are looking again at the idea of bad banks. After all, one U-turn deserves another.

Buttonwood

In praise of volatility

Jan 15th 2009
From The Economist print edition

Smooth returns can be a sign of danger for investors

Illustration by S. Kambayashi

THE irony is neat. The latest victim of the Madoff scandal turns out to be a small American hedge fund called GMB Low Volatility, which found it had 17% of its assets invested with the alleged fraudster through a third party.

Low volatility was a large part of Bernard Madoff's appeal. He offered nice, smooth returns—such a contrast with the violent excesses of the stockmarket. After all, everyone knows that volatility is a bad thing.

This obsession with smoothness grew, in part, from the way that fund managers' returns are analysed. Half a century ago little information was available and clients barely knew whether their fund manager was outperforming his peers. Eventually benchmarks were established and managers were judged on whether they beat the industry, or the stockmarket, average. But beating the average was not enough. Academics pointed out that it was possible to outperform in the short term, simply by taking a lot of risk.

That led to the widespread use of the Sharpe ratio as a measurement tool. The ratio, devised by a Nobel-prize winning economist, looks at the relationship between investment returns and their variability. The higher the ratio, the more reward there is for a given amount of risk.

Clients who use this ratio may end up flocking to a manager who earns a relatively modest return with very low volatility. Indeed, that was an important part of the appeal of the hedge-fund industry; it often did not match the stockmarket in the bull years but made up for it by outperforming during bear markets.

In theory, a focus on low volatility makes little sense for a pension fund or college endowment which has the luxury of taking the longer-term view. Like Warren Buffett, such funds should prefer a bumpy 15% return to a smooth 10%.

In practice, accounting changes may have forced pension funds to pay more attention to the short term. Furthermore, it may well be hard for investors to spot the difference between a fund manager who is able to produce a high, but volatile, long-term return and one who is simply erratic and incompetent.

But opting for a low-volatility manager also has huge potential drawbacks. Where is that low volatility coming from? It might be that the manager is buying illiquid assets. Because such assets are traded rarely, they change price rarely as well. The returns may look smooth but this is an illusion—property and private equity can fall into this category.

A second possibility is that the manager has adopted a strategy with highly skewed returns; lots of small gains but the occasional big loss. For example, the manager could be selling insurance against a big stockmarket fall. Most of the time such falls do not happen, and the manager keeps the premium. But when the market falls, the insurer may have to pay out all his previous gains. Such strategies have been described as "picking up nickels in front of steamrollers".

The more sophisticated the fund manager appears to be, and the more complex his model, the harder it is for the client to tell whether the strategy will produce skewed returns. Long-Term Capital Management, a hedge fund that collapsed in 1998, was run by highly experienced traders and economists. Its performance was brilliant, until it crashed.

The need to maintain smooth returns also tempts managers to resort to fraud when things go wrong. The

lesson applies to company executives as well as fund managers; think of all those firms that made a habit of beating profits estimates by a penny every quarter. A survey of financial professionals undertaken by two academics, Charles Mulford and Eugene Comiskey, both of the Georgia Institute of Technology, found that three of the main motivations for "creative accounting" were to reduce the volatility of earnings, help the company meet forecasts and boost the share price. Enron was a classic example of a company that pulled out all the stops to meet profit targets.

Eliminating fraud may therefore need a change in attitude among investors. Life, after all, is volatile. Economies do not grow at a steady rate for ever, as the world is discovering; indeed, previous attempts to avoid downturns may have created the conditions for this recession to be especially severe.

Markets do not rise at a steady pace and business conditions do not allow for a smooth rise in profits. A focus on meeting short-term targets, whether for profits or for investment returns, is likely to be detrimental in the long run. As Marie Lloyd, a music-hall star, used to sing: "A little bit of what you fancy does you good." A little bit of volatility, too.

The Securities and Exchange Commission

Growing insecurities

Jan 15th 2009 | NEW YORK
From The Economist print edition

The agency is in as much turmoil as the markets it polices

WHEN Christopher Cox took over the Securities and Exchange Commission (SEC) in June 2005, George Bush praised him as "a champion of the free-enterprise system" who understood that it was "built on trust". These days unfettered capitalism is under siege and trust is in short supply—not least trust in the SEC itself. As Mr Cox prepares to step down, the SEC is fighting to justify its existence. It is unlikely to be unscathed by the planned regulatory overhaul under Barack Obama.

EPA

How sharp-eyed is Schapiro?

The SEC's mission is to protect investors, maintain orderly and efficient markets and make capital formation easier. All but the most extreme libertarians would concede that government has a role to play in each, but the commission has been found wanting in the first two. Most shockingly, it failed to act on repeated allegations about Bernard Madoff's Ponzi scheme, a lapse that the SEC's inspector-general is probing. What is the point of all the enforcement actions—a near-record 671 last year—if the whoppers slip through the net?

On efficient markets, the blot on Mr Cox's copybook is the ban on short-selling financial shares late last year. Not only did this prove ineffective, but it caused havoc with legitimate hedging strategies, pushing up losses for banks and hedge funds. Mr Cox was queasy about the ban but gave in to pressure from the Treasury, which saw it as essential to prevent a systemic collapse. "Knowing what we now do, I imagine it's not a step we would take again," he says.

And then there are the investment banks that fell under the SEC's purview. It failed to appreciate the inadequacy of standards designed for commercial banks when applied to securities firms. True, Congress had hobbled the commission by giving it only limited authority—of the 200 or so subsidiaries of Lehman Brothers' holding company, for instance, it had statutory power over just seven. But Mr Cox was slow to

ring the alarm.

He is on firmer ground when it comes to accusations of passivity at key points in the crisis, such as Bear Stearns's takeover by JPMorgan Chase. The SEC was never designed to lead bail-outs. Still, some staffers feel he did too little to counter the perception that the commission was being sidelined in the rescue efforts.

This has cast a shadow over progress in other areas. Mr Cox's SEC has led the push for greater global regulatory co-operation and for American firms to adopt international accounting standards. It has democratised disclosure of company accounts using interactive databases. Mr Cox has also forced more transparency on executive pay, belying his pre-SEC reputation as a friend of Big Business.

All in all, however, the crisis has exposed the SEC as a cracked piston in a sputtering regulatory engine that dates back to the 1930s. Agencies regulate firms "according to what they were born as, not what they do today," complains Harvey Pitt, a former SEC chairman. An example is the nonsensical separation of oversight for securities, performed by the SEC, and derivatives, done by the Commodity Futures Trading Commission (CFTC).

Mr Obama has talked about the need for regulatory consolidation. Mary Schapiro, who is due to succeed Mr Cox later this month, pending Senate approval, has publicly advocated merging the two agencies. This would require a doctrinal ruling, since the CFTC's approach is far more principles-based than that of the SEC, which cleaves to hard rules. It would also call for some deft politics, since they are overseen by separate congressional committees, for whose members disbandment would mean an end to juicy campaign contributions from financial firms.

Bigger changes may be afoot. Regulation will probably be extended to new areas, such as credit-default swaps, which may fall to the SEC. But, under one proposal, the SEC would be replaced by a new business-conduct regulator, with some of its present activities going to other agencies; it has already lost some powers to the Federal Reserve, which is carving out a role as a systemic-risk watchdog. Although a career gamekeeper, Ms Schapiro is said to be more concerned with redrawing the regulatory architecture than protecting turf. That may be just as well.

China's trade

Surplus to requirements

Jan 15th 2009 | HONG KONG
From The Economist print edition

Why is China's trade surplus growing when its exports have collapsed?

THIS week revised figures revealed that China overtook Germany in 2007 to become the world's third-biggest economy. At the start of last year China also looked set to become the world's biggest exporter, but a slump in exports in the final months of the year meant they remained smaller than Germany's. China's exports tumbled by 13% (in dollar terms) in the fourth quarter, leaving them 3% lower in December than a year earlier. Despite this, China's trade surplus rose to a record $457 billion at an annual rate in the fourth quarter—50% bigger than in the same period of 2007. What is going on?

In the first half of 2008 China's trade surplus did indeed shrink (see chart). But since then, although exports slumped, imports fell by much more—down by 21% in the 12 months to December. The slide in both exports and imports was exacerbated by the global credit freeze, which has made it harder for companies around the world to get letters of credit to guarantee payment. Imports were also dragged down by cheaper oil and commodity prices, and by weaker imports of materials and components used to make exports (over 50% of total imports).

But a more worrying reason why China bought less from the rest of the world is that its domestic demand has weakened. Consumer spending and manufacturing investment have so far held up reasonably well, but construction—a big user of imported raw materials—has collapsed.

With most of the world in recession, China's exports will continue to slide this year. Nomura forecasts a drop of 6%—the first annual decline for more than 25 years. Imports, on the other hand, are expected to increase. By mid-year, the government's planned massive increase in infrastructure spending will boost imports of raw materials and machinery. If so, China's trade surplus will shrink in 2009.

The collapse in exports and the consequent job losses in southern China have triggered speculation that the government might try to push down the value of the yuan. But not only would this provoke a protectionist backlash from America's new government, it would also do little to help producers. China's problem is weak foreign demand, not competitiveness. The best way for China to support its economy—and to help unwind global trade imbalances—is to bolster domestic demand.

One piece of good news this week is that, following interest-rate cuts and the government's scrapping of credit restrictions, total bank loans jumped by 19% in the 12 months to December, up from growth of 14% last summer. China is perhaps the only big economy where credit growth has heated up in recent months. If that is sustained, it could help to boost domestic spending.

China certainly cannot rely on exports any more. Becoming the world's biggest exporter will be of little comfort if global trade is spiralling downwards.

Europe's economy

Nowhere to hide

Jan 15th 2009
From The Economist print edition

The euro area’s manufacturing rump has been whipped, too

FINANCE is in retreat. The service-led economies of America and Britain, with their underemployed estate agents, mortgage brokers and bankers, are shrinking. Yet business is no better even in countries with more manufacturing muscle than financial flab. This is an equal-opportunities crisis; the euro area’s three biggest economies are in it just as deep.

In Germany industrial output fell at annualised rate of 15.1% in the three months to November compared with the previous three months; in France it fell by 14.5% and in Italy by 19.5%. Manufacturing has once again proved to be a poor refuge in uncertain times.

The crisis is global and manufacturing is more sensitive to shifts in foreign demand than services are. America and Britain, the euro area’s main export markets, are consuming less. Emerging markets are sucking in fewer capital goods from Europe. Around the world, people are buying fewer big-ticket items such as new cars and home appliances, and firms are delaying investment.

Spending at home is being squeezed too. The euro area’s consumers have high savings and low debt by rich-world standards but are nervous all the same. Unemployment is rising—even in Germany and France, where the jobs markets have been most solid. Consumer confidence has sunk to a record low.

With consumers so skittish, service industries are not faring well either. In December the purchasing-managers index for service industries fell to a new low. Julian Callow of Barclays Capital reckons euro-area GDP fell at an annualised rate of around 5% in the fourth quarter, as bad as in America.

Consumers are pulling back fastest in Spain and Ireland. Unemployment in both countries is rocketing. On January 14th Standard & Poor’s downgraded Greece’s credit rating from A to A-. It has also put Spain and Portugal under review, amid fears that high wage costs will prolong their recessions, as well as Ireland because of the collapse in its housing-related revenues and its state guarantees to banks.

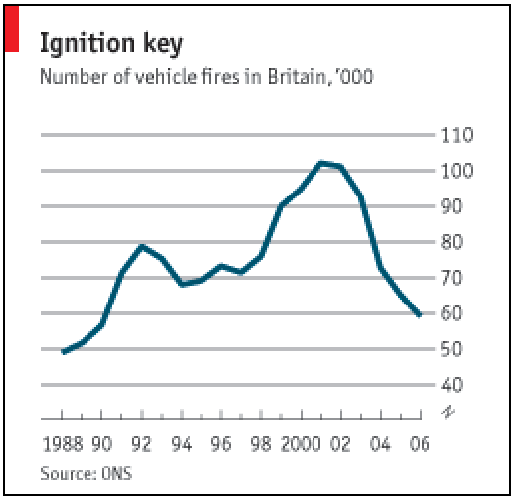
Policymakers are rattled. On January 15th the European Central Bank cut interest rates by half a percentage point, to 2%, having hinted at a pause only a month ago. Germany has at last beefed up its fiscal-stimulus package, as its exports sink. Too late, it has realised that making things is not enough; you need to buy stuff, too.

Insurance

Flames, claims and automobiles

Jan 15th 2009
From The Economist print edition

Why insurers need not fear recession



ON THE New Year's Eve just passed, 1,147 vehicles were torched on the streets of France, almost a third more than the year before. Brits too, are more partial to burning cars in times of economic strife, according to Andrew Torrance, head of British operations at Allianz, an insurer. There was an alarming rise in fires during both of the past two slowdowns (see chart). Arson is just one of the behavioural changes that drive up claims against insurance companies when economic growth stalls. Other types of crime rise. People and companies become more litigious. Firms offering credit protection are exposed to bankruptcies. At the same time, demand falls. For property insurers, say, there are fewer new factories and houses to insure. And life insurers struggle to sell policies when people are penny-pinching.

This combination of higher claims and lower new business written would appear to be toxic for underwriters. But as you might expect from the insurance industry, it is a lot more complicated than that, because recessions also tend to depress some types of claims. People drive less, reducing the number of motor accidents. The industries that often shrink most in a recession—construction and manufacturing—are among the most dangerous for workers. That means fewer payouts for insurers that have written protection against injuries. And for commercial and industrial property, though damage to premises rises, the cost of finding alternative facilities is lower.

Moreover, says Robert Hartwig, of the Insurance Information Institute, an American trade body, most existing non-life policies are nondiscretionary. In developed countries if you want to drive a car, employ a worker, or buy a house with a mortgage, you usually need insurance. At the same time, the credit crisis has eaten into insurance firms' capital—although the industry has managed its assets better than the banks have. Less surplus capital should improve underwriting discipline, pushing up rates. By most accounts this process has begun.

What is the net effect of these forces? The long-term trend in profitability (claims and operating costs as a percentage of premiums) for America's non-life insurers shows no obvious correlation with the economic cycle. Performance during the Depression, for example, was better than for most of the 1980s. That backs up analysis done by Munich Re, a veteran German reinsurer with a lot of historical data. Between 1928 and 1931, it wrote less new business but its profits did not collapse, says Heike Trilovszky, Munich Re's head of corporate underwriting. If that era is repeated, "the loss ratios of insurance companies will not be the most serious problem of mankind."

Economics focus

Looking good by doing good

Jan 15th 2009
From The Economist print edition

Rewarding people for their generosity may be counterproductive

Illustration by Jac Depczyk

A LARGE plaque in the foyer of Boston's Institute for Contemporary Art (ICA), a museum housed in a dramatic glass and metal building on the harbour's edge, identifies its most generous patrons. Visitors who stop to look will notice that some donors—including two who gave the ICA over $2.5m—have chosen not to reveal their names. Such reticence is unusual: less than 1% of private gifts to charity are anonymous. Most people (including the vast majority of the ICA's patrons) want their good deeds to be talked about. In "Richistan", a book on America's new rich, Robert Frank writes of the several society publications in Florida's Palm Beach which exist largely to publicise the charity of its well-heeled residents (at least before Bernard Madoff's alleged Ponzi scheme left some of them with little left to give).

As it turns out, the distinction between private and public generosity is helpful in understanding what motivates people to give money to charities or donate blood, acts which are costly to the doer and primarily benefit others. Such actions are widespread, and growing. The $306 billion that Americans gave to charity in 2007 was more than triple the amount donated in 1965. And though a big chunk of this comes from plutocrats like Bill Gates and Warren Buffett, whose philanthropy has attracted much attention, modest earners also give generously of their time and money. A 2001 survey found that 89% of American households gave to charity, and that 44% of adults volunteered the equivalent of 9m full-time jobs. Tax breaks explain some of the kindness of strangers. But by no means all.

Economists, who tend to think self-interest governs most actions of man, are intrigued, and have identified several reasons to explain good deeds of this kind. Tax breaks are, of course, one of the main ones, but donors are also sometimes paid directly for their pains, and the mere thought of a thank-you letter can be enough to persuade others to cough up. Some even act out of sheer altruism. But most interesting is another explanation, which is that people do good in part because it makes them look good to those whose opinions they care about. Economists call this "image motivation".

Dan Ariely of Duke University, Anat Bracha of Tel Aviv University, and Stephan Meier of Columbia University sought, through experiments, to test the importance of image motivation, as well as to gain insights into how different motivating factors interact. Their results, which they report in a new paper*, suggest that image motivation matters a lot, at least in the laboratory. Even more intriguingly, they find evidence that monetary incentives can actually reduce charitable giving when people are driven in part by a desire to look good in others' eyes.

The crucial thing about charity as a means of image building is, of course, that it can work only if others know about it and think positively of the charity in question. So, the academics argue, people should give more when their actions are public.

To test this, they conducted an experiment where the number of times participants clicked an awkward combination of computer keys determined how much money was donated on their behalf to the American Red Cross. Since 92% of participants thought highly of the Red Cross, giving to it could reasonably be assumed to make people look good to their peers. People were randomly assigned to either a private group, where only the participant knew the amount of the donation, or a public group, where the participant had to stand up at the end of the session and share this information with the group. Consistent with the hypothesis that image mattered, participants exerted much greater effort in the public case: the average number of clicks, at 900, was nearly double the average of 517 clicks in the private case.

However, the academics wanted to go a step further. In this, they were influenced by the theoretical model of two economists, Roland Benabou, of Princeton University, and Jean Tirole, of Toulouse University's Institut d'Economie Industrielle, who formalised the idea that if people do good to look good, introducing monetary or other rewards into the mix might complicate matters. An observer who sees someone getting paid for donating blood, for example, would find it hard to differentiate between the donor's intrinsic "goodness" and his greed.

Blood money

The idea that monetary incentives could be counterproductive has been around at least since 1970, when Richard Titmuss, a British social scientist, hypothesised that paying people to donate blood would reduce the amount of blood that they gave. But Mr Ariely and his colleagues demonstrate a mechanism through which such confounding effects could operate. They presumed that the addition of a monetary incentive should have much less of an impact in public (where it muddles the image signal of an action) than in private (where the image is not important). By adding a monetary reward for participants to their experiment, the academics were able to confirm their hypothesis. In private, being paid to click increased effort from 548 clicks to 740, but in public, there was next to no effect.

The trio also raise the possibility that cleverly designed rewards could actually draw out more generosity by exploiting image motivation. Suppose, for example, that rewards were used to encourage people to support a certain cause with a minimum donation. If that cause then publicised those who were generous well beyond the minimum required of them, it would show that they were not just "in it for the money". Behavioural economics may yet provide charities with some creative new fund-raising techniques.

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*"Doing Good or Doing Well? Image Motivation and Monetary Incentives in Behaving Prosocially", by Messrs Ariely, Bracha and Meier. Forthcoming in *American Economic Review*, March 2009.

Psychology

The price of prejudice

Jan 15th 2009
From The Economist print edition

Getty Images

It's what you do that counts—not what you say you'd do

NOBODY likes to admit an uncomfortable truth about himself, especially when charged issues such as race, sex, age and even supersized waistlines come into play. That makes the task of the behavioural scientist a difficult one. Not only may participants in a study be lying to those running a test, but they may also, fundamentally, be lying to themselves.

Prising the lid off human assumptions and hidden biases thus requires clever tools. One of the most widely deployed, known as the implicit-association test, measures how quickly people associate words describing facial characteristics with different types of faces that display those characteristics. When such characteristics are favourable—"laughter" or "joy", for example—it often takes someone longer to match them with faces that they may, unconsciously, view unfavourably (old, if the participant is young, or non-white if he is white). This procedure thus picks up biases that the participants say they are not aware of having.

Whether these small differences in what are essentially artificial tasks really reflect day-to-day actions and choices was, until recently, untested. But that has changed. In a paper to be published next month in *Social Cognition*, a group of researchers led by Eugene Caruso of the University of Chicago report their use of a technique called conjoint analysis, which they have adopted from the field of market research and adapted to study implicit biases in more realistic situations.

Conjoint analysis, they think, lets them quantify what has been dubbed the "stereotype tax"—the price that the person doing the stereotyping pays for his preconceived notions. In two studies, they turn their new tool loose on questions of the perception of weight and sex.

Know thyself not

Conjoint analysis asks participants to evaluate a series of products that vary in several important attributes, such as televisions of various screen sizes, brands and prices. By varying these attributes in a systematic way market researchers can measure with reasonable precision how much each trait is worth. They can then calculate how big a premium people are willing to pay in one attribute (price) to get what they want in another (a larger screen).

In their first study, Dr Caruso and his team recruited 101 students and asked them to imagine they were taking part in a team trivia game with a cash prize. Each student was presented with profiles of potential team-mates and asked to rate them on their desirability.

The putative team-mates varied in several ways. Three of these were meant to correlate with success at trivia: educational level, IQ and previous experience with the game. In addition, each profile had a photo which showed whether the team-mate was slim or fat. After rating the profiles, the participants were asked to say how important they thought each attribute was in their decisions.

Not surprisingly, they reported that weight was the least important factor in their choice. However, their actual decisions revealed that no other attribute counted more heavily. In fact, they were willing to sacrifice quite a bit to have a thin team-mate. They would trade 11 IQ points—about 50% of the range of IQs available—for a colleague who was suitably slender.

In a second study the team asked another group, this time of students who were about to graduate, to consider hypothetical job opportunities at consulting firms. The positions varied in starting salary, location, holiday time and the sex of the potential boss.

When it came to salary, location and holiday, the students' decisions matched their stated preferences. However, the boss's sex turned out to be far more important than they said it was (this was true whether a student was male or female). In effect, they were willing to pay a 22% tax on their starting salary to have a male boss.

A black and white answer

A recent paper in *Science* adds further fuel to the notion that implicit biases and inaccurate self-perceptions do indeed exist and need further study. A team led by Kerry Kawakami from York University in Canada conducted an experiment to try to understand how racism persisted despite most people roundly condemning it.

Dr Kawakami, too, used students. She recruited 120 who identified themselves as not being black, and then divided them into two equal groups. Members of one group were brought, one by one, into a waiting room with two other "students", one black and one white, who were, in fact, in on the experiment.

As they waited, the black "student" stepped out of the room to retrieve a mobile phone, gently bumping the knee of the white "student" on the way out. Then, one of three things happened: either the incident passed without comment; or the white "student" remarked "Typical, I hate it when black people do that"; or he sniped "Clumsy nigger". At this point, the study master returned and administered a test meant to measure emotional state. Finally, the study participant was asked to choose one of the two "students" as a partner for a subsequent test.

The other group was treated slightly differently. Participants were not actually brought into the waiting room but were asked to imagine themselves there, either by reading a description of what happened or by watching a videotaped version of the proceedings.

Both those who read what had happened and those who witnessed it on television thought they would be much more upset in the cases involving racist comments than the one involving no comment at all. However, those who had actually been in the waiting room showed little distress in any of the three cases.

In addition, a majority of those imagining the encounter predicted that they would not pick the racist student as their partner. However, those who were actually present in the room showed no tendency to shun the white student, even when he had been rude about the black one. People, it seems, are rather more prejudiced than they think they are.

Animal behaviour

The song of songs

Jan 15th 2009
From The Economist print edition

A hyrax's song gives a detailed account of his wares

AS WE reported a few weeks ago ("Why music?" December 20th 2008), one explanation for the evolution of human music is that it helps to seduce the opposite sex. Both singing and playing an instrument are complex activities in which errors are easily detected, and which require both intelligence and muscle control to do well. Music is thus a demonstration of the underlying fitness of the singer, or player.

This is still a controversial hypothesis. Those who support it argue that other animals sing, too, and that their songs often seem to be connected with courtship. The details, however, are obscure. Zoologists have worked out the meaning of some calls (the quality of the "snarr" produced by a male water pipit, for example, shows his position in the dominance hierarchy, while the rattle made by a male barn swallow indicates his testosterone levels). What they have not discovered is whether more complex songs can be decomposed into separately meaningful elements. To investigate that question, Lee Koren and Eli Geffen of Tel Aviv University decided to take a close look at the rock hyraxes of the Judean desert.

They knew that hyraxes (small, furry animals that are the closest living relatives of elephants) sing to one another, and they suspected that the songs have something to do with courtship, since they happen less frequently once the animals have mated. Otherwise, though, they had little idea what hyraxes were singing about. Over three years, therefore, Dr Koren recorded the songs and studied the behaviour of 18 male hyraxes, and also collected their fur for hormone analysis. Then, she and Dr Geffen analysed the data to look for correlations between the pattern of a hyrax's song and other details of its anatomy and behaviour. They discovered, as they report in *Behavioral Ecology and Sociobiology*, that male hyraxes are doing far more than just repetitively communicating that they are ready to mate. They are providing their neighbours with a list of vital statistics: their body weight, size, health, social status and hormonal levels.

Wailing, which starts a typical hyrax song, indicates weight. The more wails, the heavier the singer. A mid-song sound that Dr Koren and Dr Geffen dubbed "chucks" communicates size (body length and head diameter) and also level of stress (as measured by cortisone levels). Songs conclude with a series of snorts that are connected to the singer's levels of certain male hormones. Finally, the researchers discovered that peaks in snort-frequency provided information on an animal's dominance, and also the condition of its pelt.

The unstated assumption is that these are all honest signals—that is, their frequency or the quality of their production is directly related to the singer's underlying physiology and cannot be modified to give a false impression of his fitness. Lady hyraxes are therefore provided with a reliable précis of the strengths and weaknesses of each of their potential mates.

Whether this work sheds any light on human music is unclear. Human songs do not seem to contain the equivalents of wails, chucks and snorts. But that might be because humans are so close to the subject that they cannot see what those equivalents are. For example, a listener can gather a lot of information from the difference between a bass, a baritone and a tenor without ever seeing the singer. A man's musical range is related to his size and to the anatomy of his voice box. That, in turn, is dictated when his voice breaks during the testosterone surges of puberty, so it may give away something about his hormonal status. Moreover, even wordless music can convey the player's emotional state. Perhaps, then, humans and hyraxes are not so different. Something to think about when next you are tempted to sing in the bath.

Neuroeconomics

Digitally enhanced

Jan 15th 2009
From The Economist print edition

Successful financial traders are born as well as made

MAKING money comes naturally to some people—specifically, to men exposed to high levels of testosterone before they were born. That, at least, is the conclusion of a study published this week by John Coates of the University of Cambridge and his colleagues.

Reuters

Pull your finger out!

Testosterone levels normally surge during the middle of a pregnancy. This not only shapes the brain and sex organs of the child, but also affects the way its fingers grow. High levels of the stuff extend the ring fingers, making them longer than the index fingers. In general, men have relatively longer fourth fingers than women. Previous research has shown that men with significantly elongated ring fingers excel at competitive sports. Dr Coates wanted to know whether such men also did well at financial trading.

To find out, he recruited 44 men from a trading floor of about 200, all but three of whom were male, in the City of London. The people on this floor specialise in "high-frequency" or "noise" trading, in which traders buy securities, specifically futures contracts, in sums of up to £1 billion—but who hold their positions for only a few minutes, and sometimes just seconds, before selling. This rapid style of trading is particularly demanding. Traders must be vigilant as they search for small price discrepancies both within and between markets, and they must be quick to react to changes in these prices.

Dr Coates and his team measured the ratio of the length of the men's index and ring fingers from photocopies of their right hands. They then examined the profit and loss statements for each trader recorded over 20 months. Unsurprisingly they found that nurture, in the form of experience, counted for a lot. But they also discovered that nature was important. Those men whose ring fingers were significantly longer than their index fingers made more money. As they report in the *Proceedings of the National Academy of Sciences*, among people who had worked in the City for more than two years, those with skewed hands earned more than five times as much as their more even-fingered brethren. Such men also remained in the business for longer.

Last year, Dr Coates reported a different experiment in which he found that traders who had high levels of testosterone in their bodies in the morning went on to make the most money during the day. Next, he plans to try to establish whether asset managers, who seek to make gains over years rather than minutes, are helped by a lack of testosterone—and thus to discover whether, when it comes to making money, there is more than one way of prospering naturally.

Deforestation and extinction

Second life

Jan 15th 2009
From The Economist print edition

Biologists debate the scale of extinction in the world's tropical forests

A RARE piece of good news from the world of conservation: the global extinction crisis may have been overstated. The world is unlikely to lose 100 species a day, or half of all species in the lifetime of people now alive, as some have claimed. The bad news, though, is that the lucky survivors are tiny tropical insects that few people care about. The species that are being lost rapidly are the large vertebrates that conservationists were worried about in the first place.

This new view of the prospects for biodiversity emerged from a symposium held this week at the Smithsonian Institution in Washington, DC, but the controversy over how bad things really are has been brewing since 2006. That was when Joseph Wright of the Smithsonian Tropical Research Institute in Panama and Helene Muller-Landau of the University of Minnesota first suggested that the damage might not be as grim as some feared. They reasoned that because population growth is slowing in many tropical countries, and people are moving to cities, the pressure to cut down primary rainforest is falling and agriculturally marginal land is being abandoned, allowing trees to grow.

This regrown "secondary" forest is crucial to the pair's analysis. Within a few decades of land being abandoned, half of the original biomass has returned. Depending on what else is nearby, these new forests may then be colonised by animals and additional plants, and thus support many of the species found in the original forest.

Dr Wright and Dr Muller-Landau therefore reckon that in 2030 reasonably unbroken tropical forest will still cover more than a third of its natural range, and after that date its area—at least in Latin America and Asia—could increase. Much of this woodland will be secondary forest, but even so they suggest that in Africa only 16-35% of tropical-forest species will become extinct by 2030, in Asia, 21-24% and, in Latin America, fewer still. Once forest cover does start increasing, the rate of extinction should dwindle.

There are, however, two criticisms of this analysis. The first questions whether the raw data about forest cover are a good indicator of biodiversity, at least for big animals. William Laurance, a colleague of Dr Wright's, pointed out to the symposium that birds and mammals are more vulnerable to alterations in their habitat than are insects and other small animals. His data suggest that even in some of the world's best-protected primary forests, these species face severe pressures.

Elizabeth Bennett, of the Wildlife Conservation Society, an American conservation group, agreed and mentioned that for large birds and mammals, uncontrolled hunting for food and for trade is causing a phenomenon known as "empty-forest syndrome". She said that although many forests look healthy when viewed from a satellite, they are actually falling silent because many of their large animals have been removed for subsistence or profit.

Nonetheless, the symposium's participants agreed that the number of species of large animals may no longer be reliable indicators of the status of the millions of other species that live in a forest, and about which far less is known. Most species, as Nigel Stork of the University of Melbourne pointed out, are insects—and these are more resilient and much less threatened.

A diversity of opinion

The second criticism of Dr Wright's and Dr Muller-Landau's view questions their interpretation of the link between a country's population and its rate of deforestation. Dr Laurance suggested this link may not be as strong in the future as it once was. In the past two decades, he said, many parts of the tropics have seen a rise in industrial forms of land use such soya-bean farming, oil-palm plantations, and oil and gas development, together with the road-building and other construction projects that these bring in their wake. Such activities vary with the demands of international markets, not the size of the local population.

In particular, Dr Laurance is worried that the liberalisation of agricultural trade and the rise of biofuels could lead to a huge increase in demand for land in the tropics.

What everyone agreed, though, was that climate change is a threat. Even the optimistic Dr Wright is worried. He warned the meeting that because many tropical species evolved in an environment that has very little temperature variation, they are not equipped to cope with an increase of as little as 3ºC, which is the sort of change that many climate scientists predict. Such species may thus have to migrate long distances if they are to survive. He said that by the end of the century, 75% of tropical forests will be warmer than today, and what will remain in these hot, wet places is unknown.

American presidential history

Honest Abe, reborn

Jan 15th 2009
From The Economist print edition

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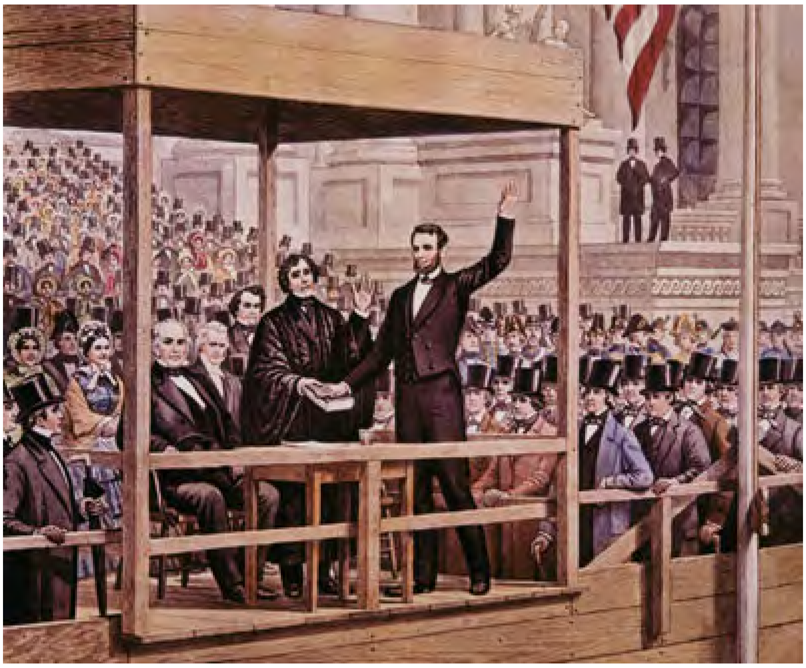
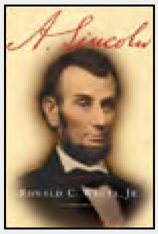


Now more than ever, Abraham Lincoln towers over American presidential politics

A. Lincoln: A Biography
By Ronald C. White



Random House; 816 pages; $35

Buy it at
Amazon.com
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THE many biographers and curators pumping out material on Abraham Lincoln must be congratulating themselves on truly extraordinary timing. Not only is next month the 200th anniversary of the log-cabin birth of the Great Emancipator, but Barack Obama will also conspicuously carry the banner of his Illinois forebear into the White House on January 20th.

Mr Obama has asked to take his oath on the same Bible that Lincoln used at his 1861 swearing-in (pictured above). Other parallels are so persistent as to become almost tiresome. Mr Obama and Lincoln were both politician-lawyers from Springfield who outfoxed heavily favoured New York opponents during the party primaries, namely William Seward (then a senator from New York) and Hillary Clinton. Both owed their rise to masterful oratory; both brought (or bring) thin governing experience to the presidency.

To read any biography of Lincoln in the present context is a rich experience. Mr Obama is known to favour “Team of Rivals”, Doris Kearns Goodwin’s absorbing 2005 account of how Lincoln swept his political challengers into his cabinet. (Seward ended up as secretary of state, as presumably will Mrs Clinton.)

Still, the torrent of Lincoln books past and present—including over a dozen in the next few months alone—means that the bar is necessarily set high. “A. Lincoln: A Biography”, by Ronald White junior, an academic and established Lincoln historian, will be among the most substantial new entrants. Mr White sets out to chronicle Lincoln’s moral and intellectual evolution. Such territory has of course been substantially covered already. For some 150 years, virtually every paper and pronouncement by the 16th president has been pored over by historians, not least by Mr White, whose analysis of Lincoln’s second inaugural address in his 2002 book, “Lincoln’s Greatest Speech”, is well worth perusing. Indeed, Mr White’s particular passion is Lincoln’s rhetoric, and the biographical bulk of the new book is mashed together, sometimes awkwardly, with line-by-line analyses of Lincoln’s inaugurals and other major

speeches.

In fact, the subject is entirely capable of speaking for himself. Lincoln was self-deprecating and funny in a way that will ring true for the Jon Stewart generation. Just as Mr Obama managed to call himself a black and white "mutt" on national television, so Lincoln good-humouredly adjusted to the consensus description of himself as one of the ungainliest men in politics. Matthew Brady, posing Lincoln for a photograph in New York just before his famed Cooper Union speech in 1860, suggested fixing his collar. Lincoln replied, to the amusement of both men, "I see you want to shorten my neck." Another time, assuming a large debt upon the death of a former business partner in 1835, Lincoln began calling it his "National Debt", due to its size and the geographic spread of his creditors.

To be sure, Lincoln also had plenty of miscues. Shortly before his 1861 inauguration, he told the Ohio legislature: "It is a good thing that there is no more than anxiety, for there is nothing going wrong." Never mind that half a dozen states had just seceded from the Union. John McCain's ill-fated assertion in September that "the fundamentals of our economy are strong" seems mild by comparison.

Ultimately, of course, Lincoln saved the Union, issued the Emancipation Proclamation and stood firmly by it, despite criticism. But the road to historical favour was long and complex, as Mr White shows. Until the promotion of Ulysses S. Grant, the North's victory in the civil war was held back by a series of inept generals—to the exasperation of Lincoln, who liked to read up on military strategy.

As for slavery, Lincoln had long railed against this "monstrous injustice". But one of the bitterest questions of the day was whether the federal government could ban slavery in new American territories, such as Kansas and Nebraska. Lincoln was firmly against extending slavery in the territories, but did not seek at first to eradicate the "peculiar institution" altogether.

In his first inaugural address, Lincoln quoted from an earlier speech, in which he had said: "I have no purpose, directly or indirectly, to interfere with the institution of slavery in the States where it exists. I believe I have no lawful right to do so, and I have no inclination to do so."

Less than three years later at Gettysburg, Lincoln was speaking of a "new birth of freedom" for the nation, and shortly thereafter he backed the Thirteenth Amendment, fully outlawing slavery. "Well, boys, your troubles are over now," Lincoln told his press pool (of sorts) the morning after being elected in 1860. "Mine have just begun." As he places his hand on the Lincoln Bible, Mr Obama may feel much the same way.

A. Lincoln: A Biography.
By Ronald C. White.
Random House; 816 pages; $35

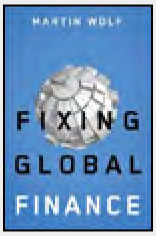
The financial crisis

Don't forget the benefits

Jan 15th 2009
From The Economist print edition

FINANCIAL history has been sliced in two: there is BC and AD—Before Crisis and After Disaster. Any financial book conceived in far-off BC times would seem unlikely to be relevant in the AD era. But Martin Wolf's "Fixing Global Finance" is an exception. If Mr Wolf were to rewrite his book—a new edition is promised at some point—he would no doubt shift his emphasis. But his first run at the subject, which grew out of a series of lectures delivered in early 2006 and comes out in Britain later this month after being published in America last September, holds up remarkably well despite all that has happened.

Fixing Global Finance
By Martin Wolf



Johns Hopkins University Press; 248 pages; $24.95. Yale University Press; £18.99

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Mr Wolf, chief economics commentator for the *Financial Times*, begins with a truth that is easy to forget: sophisticated finance does bring benefits. Finance allows the creation of vast enterprises out of the combined capital, supplied at modest cost, of millions of people. It permits upstarts to launch companies, challenging the power of incumbents. It allows people to smooth their spending over a lifetime. It facilitates risk sharing and insurance. Empirical studies confirm that these advantages are real. Countries that had large financial sectors in 1960 grew faster over the next three decades than those that did not. A doubling in the size of private credit in a developing country has been shown to boost the growth rate by an average of 2 percentage points a year. Developing countries that open their stock markets to foreign investors reap big benefits: output per worker grows by 2.3 percentage points faster than it would have done otherwise.

So financial sophistication is a boon. But it is also dangerous. Emerging markets have endured a series of crises since the Latin American default of 1982. Advanced economies from Japan to Sweden have suffered expensive banking busts. The current crisis is a sort of super-sized, IMAX version of a depressingly familiar horror film. Mr Wolf does not quite answer the question as to whether the costs of crises outweigh the benefits of modern finance, perhaps because nobody seriously believes that it would be possible to rebottle the genie. Instead, he focuses on more practical questions. What should countries do to reduce the risk of crises? And, just as important, what have they done?

Answering the second question is the heart of this book. Emerging economies, having experienced the crises of 1997-98, resolved to inoculate themselves by refusing to rely on foreign financing. They kept their exchange rates cheap so as to run current-account surpluses and build up foreign reserves. That way, if their banks got into trouble and foreign financiers took flight, they would have a war chest of dollars with which to repay the foreigners and avoid a collapse in their currencies.

This determination to run surpluses has proved wise: Brazil, Russia and South Korea have all drawn heavily on reserves during the current crisis. But a precaution that makes sense from the perspective of one country can prove toxic for the global system as a whole. If everyone is trying to run a current account surplus, a corresponding deficit must show up somewhere. And so it did, in America. Capital from emerging markets poured into Wall Street, inflating the subprime bubble.

The scary thing is that the process could repeat itself. Having experienced the current crisis, emerging nations may redouble their determination to export capital and another bubble could be inflated. This makes Mr Wolf's first question urgent: how should countries make finance safer without resorting to the destabilising policy of capital dumping?

The answer begins by distinguishing different types of capital inflow. Foreign direct investment cannot be yanked out during a panic, so it should be welcomed. Portfolio equity flows are also surprisingly stable. But credit is dangerously fickle, especially if it is denominated in a foreign currency. Emerging countries must prevent their citizens from borrowing cheaply in dollars when their incomes are in won, reais or baht: if foreigners want to lend, let them lend in local currencies. Once such currency mismatches are

minimised, the risk of exchange-rate crises will be curtailed. Emerging nations may then be ready to absorb capital from abroad. They will no longer feel the need to run current account surpluses—and America may be spared the next bubble.

Fixing Global Finance.
By Martin Wolf.
Johns Hopkins University Press; 248 pages; $24.95. Yale University Press; £18.99

Political thrillers

The young president

Jan 15th 2009
From The Economist print edition

POLITICAL thrillers are like fish fingers: squarish, stodgy, reliable. This is not to denigrate the genre—fish fingers, like tales of good against evil or avaricious corruption against unbendable righteousness, comfort and nourish—but merely to note that the modern political thriller, more even than most crime novels, hews to convention.

The most successful often trade on current political themes: David Baldacci's "Absolute Power", for instance, published in 1996, featured philandering in the White House. Leonard Downie junior's debut novel, "The Rules of the Game", concerns shady lobbyists, Halliburtonesque defence contractors and an inexperienced young president whose idealism masks a spine of steel.

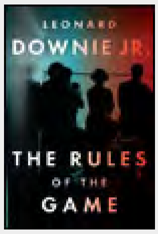
Illustration by Daniel Pudles

The book concerns the dogged efforts of Sarah Page, a young reporter for the *Washington Capital*, to uncover a conspiracy involving kickbacks, money laundering and an effort by lobbyists and defence contractors to place ethically pliable people in key positions within a new administration. She is aided by an array of familiar figures—a crusty editor, a trusty police reporter, a philandering but good-hearted political reporter, some spooky spooks—and hindered by a rogue's gallery which includes an oily political consultant, a taciturn and dangerous ex-general and an assortment of blandly threatening lawyers.

Mr Downie is an expert Washington hand, having edited the *Washington Post* for 17 years, and he keeps the plot trundling along quite competently. Ultimately, his modesty also serves him well: the novel is not so compelling as to be incredible, nor so believable as to feel worthy. If his political characters tend to speechify a bit too prettily, speaking in theses and talking points, just think what pleasure it must be for a long-time Washington journalist to finally put decent words into politicians' mouths, rather than dutifully recording their usual pontificating drivel.

The Rules of the Game.
By Leonard Downie.
Knopf; 336 pages; $26.95

The Rules of the Game
By Leonard Downie



Knopf; 336 pages; $26.95

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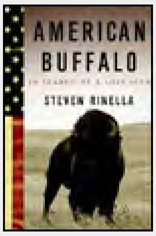
Buffalo in America

Born again

Jan 15th 2009
From The Economist print edition

IN 2005 Steven Rinella won one of 24 lottery permits to hunt a wild buffalo in the 13m-acre (5.3m-hectare) Wrangell-St Elias National Park and Preserve in Alaska. Braving grizzly bears and subzero temperatures, he searches the snow-covered wilderness for days before finally finding his quarry and making his kill, one of only four permit-holders to do so.

American Buffalo: In Search of a Lost Icon
By Steven Rinella



Spiegel & Grau; 277 pages; $24.95

Buy it at
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But that is just the half of it. A buffalo weighing around a tonne yields a lot of meat. After butchering the carcass (his biological description of the process is not for the squeamish) the author is faced with carrying it bit by bit down the mountainside before transporting it four miles by raft to civilisation. The animal provides him with meat for the best part of a year. Not a scrap is wasted.

Mr Rinella neatly blends the tale of his adventure with an anecdotal history of the buffalo and its place in the American psyche. At the time of the revolutionary war around 40m buffalo roamed the North American continent. By the mid-1890s, thanks to demand for their meat, skins and bones by Native Americans and white men alike, they were nearly extinct. In 1905, to preserve the country's remaining stocks, a group of well-to-do East Coasters, including Theodore Roosevelt, Andrew Carnegie and Frederic Remington, set up the American Bison Society (buffalo and bison being one and the same). Two years later they sent 15 animals by rail to the new Wichita Bison Refuge in Oklahoma. In 1911 the society announced that its conservation work had succeeded and buffalo were no longer in danger of extinction. In 1935 it met for the last time.

Today North America is home to half a million buffalo, only 4% of which roam free; the remainder are held within the confines of fenced ranches. In spite of the recovery of the species, the American Bison Society was revitalised in 2005, this time with a mandate to secure the ecological future of the animal on the continent.

Mr Rinella fleshes out his story with a wealth of buffalo-related statistics. A town or city called Buffalo can be found in 18 American states, though the most famous of these, Buffalo, New York, is the only one that has never had a population of wild buffalo living in its vicinity. Twice as many visitors to Yellowstone National Park are injured by the park's buffalo than by its black and grizzly bears.

The most famous buffalo in American history is Black Diamond, whose image graced the buffalo-head nickel and became the most widely distributed picture of a buffalo in the world. In 1915 Black Diamond was sold for $300 to August Silz, a meat-dealer, and slaughtered in New York's meatpacking district. The animal's carcass yielded 462kg of meat and the head went up on the wall of Silz's office. Although a buffalo head is not something to throw away lightly, no one seems to know where it is now.

"American Buffalo" pays tribute to an iconic beast. As Mr Rinella writes, the buffalo "represents a frontier both forgotten and remembered; it stands for freedom and captivity, extinction and salvation."

American Buffalo: In Search of a Lost Icon.
By Steven Rinella.
Spiegel & Grau; 277 pages; $24.95

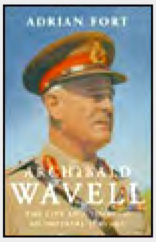
Archibald Wavell

A clever chap, and modest

Jan 15th 2009
From The Economist print edition

IN THE eyes of politicians, Archibald Wavell had fatal flaws. The penultimate viceroy of India may have possessed all the manly virtues extolled in Rudyard Kipling's famous poem "If". He was super-bright; he was comfortable in Urdu, Hindustani, Russian, Latin and classical Greek; he usually finished the *Times* crossword in 20 minutes and he knew by heart all the verses in his bestselling poetry collection, "Other Men's Flowers". But, according to Adrian Fort, Wavell's biographer, politicians appreciate "a certain deviousness in approaching problems and like to be flattered". And Wavell, tragically, was quite unable to fulfil these expectations. In consequence, he was almost always at odds with Winston Churchill, Clement Attlee, Stafford Cripps and his other political masters as he commanded the British Empire's forces, first against the Axis powers in north Africa and the Levant and then against the Japanese in Asia.

Archibald Wavell: The Life and Times of an Imperial Servant
By Adrian Fort



Jonathan Cape, 512 pages; £25

Buy it at
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Yet he was able to rub along with even the most tempestuous martinet. He was especially close to Edmund Allenby, the large, florid general known as "the Bull" whom he first encountered in the trench mud of Flanders. After a poor start he also took a shine to New Zealand's Bernard Freyberg, a general with 27 war wounds and a Victoria Cross, who was described by a contemporary as "a red-necked thug who ate two Germans for breakfast". But Wavell's greatest triumph in personnel management was the working relationship he managed to establish, despite great provocation, with Major-General Joseph ("Vinegar Joe") Stilwell, Franklin Roosevelt's personal representative, whose dislike for "Limey" officers was exceeded only by his hatred of the Japanese.

Wavell's mother, Lillie, by Mr Fort's account, seems to have had virtually no influence on her son's life. His character was moulded instead by his soldierly father and by the old-school classical education he received at Winchester College. Their combined efforts help to explain the long historical perspective Wavell brought to problems which, in turn, helped create his marked sense of detachment. When he viewed a military problem he would ponder how Napoleon or Caesar would have dealt with it. When he was sacked by the Attlee government to make way for the last viceroy of India, Earl Mountbatten of Burma, he compared his lot with that of King Nebuchadnezzar: "The exiled monarch, now put out to grass,/With patient oxen, and the humble ass,/Said as he champed the unaccustomed food,/'It may be wholesome, but it is not good.'"

Churchill was exasperated by his long silences, and King George VI nicknamed him "the oyster" after a sticky audience, yet Wavell could open up in the company of those who shared his love of the arts, especially literature and poetry. He revelled in the company of Chips Channon, Cecil Beaton and Siegfried Sassoon. Nancy Cunard said she longed to dine with him twice a week; Diana Cooper felt she "might fall in love with him". Wavell also put in a lot of hard graft as president of the Poetry Society, the Royal Society of Literature and the Browning Society. Throughout he remained characteristically modest, describing himself as "a good journeyman soldier" and "one of the Unintelligentsia".

Archibald Wavell: The Life and Times of an Imperial Servant.
By Adrian Fort.
Jonathan Cape, 512 pages; £25

Gustavo Dudamel

A “yes we can” maestro

Jan 15th 2009 | NEW YORK
From The Economist print edition

The young Venezuelan maestro warms up for his move to Los Angeles

AP

GUEST conductors at the New York Philharmonic Orchestra are not usually allowed to use Leonard Bernstein’s batons. Gustavo Dudamel is one of the few. There are similarities between the passionate, intuitive music making of the Philharmonic’s most famous music director and Mr Dudamel, who becomes music director of the Los Angeles Philharmonic next season. But perhaps of greater significance is the vision that the 27-year-old Venezuelan shares with Bernstein that the arts are a means of improving society.

Mr Dudamel, who is back in New York this month conducting Gustav Mahler’s Symphony No. 5, which he has made something of a signature piece, is a product of *el sistema*. The much-lauded Venezuelan network of youth orchestras, founded by José Antonio Abreu in 1975, provides free instruments and tuition to children and teenagers, many from deprived areas who might otherwise be tempted by drugs and petty crime.

The success of Mr Dudamel and *el sistema* inspired the recent launch of the Youth Orchestra LA (YOLA), which also aims to help disadvantaged children. Mr Dudamel and the LA Philharmonic hope to expand the programme throughout the metropolitan area, following the example of the Venezuelan system, which encompasses hundreds of ensembles.

Those include the Simón Bolívar Youth Orchestra, which Mr Dudamel has conducted since 1999 and with which he has released several vibrant recordings on the Deutsche Grammophon label, including the fifth symphonies of Beethoven and Mahler. In 2007 the young musicians impressed critics and audiences with their polished performances of Beethoven and Berlioz. They donned jackets emblazoned with the Venezuelan flag for exuberant renditions of Latin American works and leapt from their seats and twirled their instruments while playing pieces from Bernstein’s “West Side Story”. As Mr Dudamel says, “The Latin blood is like champagne. There’s always movement. People say we Venezuelans are crazy and we are. It’s our soul. I’m very proud of this.”

Mr Dudamel, who trained initially as a violinist, wanted to become a conductor at the age of four, after attending a concert in which his father, a professional trombonist, performed. He first attracted international attention when he won the 2004 Gustav Mahler International Conducting Competition in Bamberg, Germany. Esa-Pekka Salonen, the LA Philharmonic’s current music director, was on the jury and told Deborah Borda, the orchestra’s president, about Mr Dudamel’s prodigious talent. She recalls watching him rehearse Mahler’s fifth symphony with the orchestra of La Scala in Milan. They initially sounded “like an Italian military band playing Mahler”, she says. But after a few hours with Mr Dudamel, whose rehearsal style she describes as “polite, productive and upbeat”, the ensemble began to sound more like the Vienna Philharmonic.

Steven Witser, principal trombonist of the LA Philharmonic, appreciates how Mr Dudamel “blends youthful energy and exuberance with thoughtful and serious music making”. Many conductors are “huge personalities”, he adds, “but Gustavo has an innocence about him.” A warm welcome also awaits Mr Dudamel outside the concert hall. The Los Angeles Lakers gave him a jersey decorated with his name.

An idealist in the Bernstein mould, the energetic curly-haired maestro believes the state should offer every child in America a musical education, as happens in Venezuela. “We have to educate society. With music or arts, it has to be coming from the state. This will come, I’m sure,” he says with the optimism of someone who hasn’t yet lived in a country without low-cost health care, much less free violins. “When you change the life of one kid, you change the life of the complete family. When you’re in front of these kids, you realise it’s very important not only for the future of classical music, but for the future of the world.” A “yes we can” maestro indeed.

Richard Neuhaus

Jan 15th 2009
From The Economist print edition

Richard Neuhaus, a turbulent American priest, died on January 8th, aged 72

First Things

WHILE the rest of the world fawned on Barack Obama, Richard Neuhaus took no joy in him. If Mr Obama truly meant, as he said, to liberalise abortion rules from his first day in office, Father Neuhaus foresaw an intensification of the culture wars at every level of American life. But he was ready to fight his side. For 30 years he had done so in books, manifestos, studies for the American Enterprise Institute and 12,000-word columns in *First Things*, the journal of his own Institute on Religion and Public Life. He fought his conservative corner in fluent, fervent, gossipy conversations, smoothed with bourbon and cigars and interrupted by immersion in Bach. George Bush, among many others, found talking to "Father Richard" on cloning, or same-sex marriage, superb for clearing the head. And he made his point even as, day by day, he raised Christ's body at his church on the lower East Side of Manhattan. For the Eucharist, too, was a "call to commitment", an "evangelistic" act.

Without Father Neuhaus, the religious right might still have enjoyed its 20-odd years of ascendancy in American politics. But it would have lacked much of its intellectual spine. Father Neuhaus, a Lutheran-turned-Catholic fearsomely well read in both the Church Fathers and the Protestant dissenters, encouraged evangelicals and Catholics to join forces to fill, with a new moral philosophy, the empty space at the core of modern American public life. There was, he wrote in 1984, a "naked public square" from which religion had been banished, and which "seven demons", all secular, now competed to control.

The separation of church and state might be enshrined in the constitution. But Father Neuhaus saw it as impossible in a fundamentally religious country, whose history had been driven since the *Mayflower* by a dynamic conviction of the usefulness of America to the purposes of God. And by ignoring religion when people were mostly believers, it threatened the legitimacy of American democracy itself. "Judicial usurpation", was Father Neuhaus's term for it. He had the Supreme Court in his sights, and much else.

Riding the Holy Spirit

All this was unfolded as confidently as Augustine's tracts against the Pelagians, which he knew backwards. The church he loved was celibate, hostile to women priests and set against gays; if Catholics

were only faithful to the teachings of the Magisterium, he wrote, all would be well. Divine grace would clarify all matters "in due course", just as his own path had been steered from running a petrol station in Cisco, Texas, a high-school drop-out's job, to the stiff white collar of a priest. A print in his living room showed a boy in flight on a strange bird: "That's little Dickie Neuhaus, riding the Holy Spirit," he told a friend.

His critics lamented that this man, so bullishly authoritarian and neoconservative, had once been quite different. His first years as a Lutheran pastor in the 1960s saw him as a preacher in a black Brooklyn parish so poor it could not pay him; a marcher for civil rights in Selma, Alabama, arms linked with Martin Luther King; a delegate for Eugene McCarthy in Chicago, banged up with Norman Mailer for defying the police; and a co-founder of a clerical pressure group against the Vietnam war. His slide to the right, even as far as support for the Iraq venture, seemed inexplicable.

But to him there had been no slide. He had remained steadfastly "politically liberal and culturally conservative". He still, he hoped, spoke truth to power, assuming he knew what truth was. But in 1968 he was already bothered that only "heartless conservatives" defended the rights of the unborn. When abortion was legalised in the *Roe v Wade* ruling of 1973, he felt America had moved away from him. He had not budged. The man who had wanted "revolution for the hell of it" was the same who, years later, enthused about the "high adventure" of orthodoxy. Both were out on a limb, ferociously challenging the slovenly relativism of everyone else. Both were firmly positioned where the noisiest political action was. And both revelled in "the utterly gratuitous love of God by which we live astonished".

He did not feel he had shifted from Lutheranism, either. His conversion to Catholicism in 1990 was just the "completion and right ordering" of all he had learnt in the Lutheran church, including the prayers he had been taught by his pastor father. Luther, he pointed out, had always wanted the Christian church to unite. He himself had made steps to do the same by courting evangelicals like Jerry Falwell; not because he liked them or rated their intelligence (by and large, he thought them crude), but because unity boosted God's cause in American public life.

The greatest contradiction in Father Neuhaus was not indeed between left and right, or Protestant and Catholic. It was between the "Dickie Neuhaus" who boisterously took charge of everything, and the man who knew he was not in charge at all. In 1993 he almost died when a tumour ruptured in his intestines. As he was dying, two "presences" appeared and gave him a message: "Everything is ready now." What it meant he was not sure. The matter would be clarified in due course. Ready for continuing, untiring struggle against America's secular demons; or ready for resignation to some different call.

Overview

Jan 15th 2009
From The Economist print edition

The slump in **America's economy** deepened. The unemployment rate rose from 6.8% to 7.2% in December. Firms, excluding farms, cut 524,000 workers from their payrolls that month. The number of jobs lost in November was revised up, to 584,000. October's payroll cull was 423,000. The value of retail sales fell by 2.7% in December, the sixth consecutive monthly decline, leaving them 9.8% below their level a year earlier. Sales of items other than cars fell by 3.1% in the month.

America's trade balance narrowed from $56.7 billion to $40.4 billion in November. The value of exports fell by 5.8% but imports slumped by 12%. Much of the improvement in the trade balance was owing to a fall in the value of imported oil. **China's** monthly trade surplus in December, at $39 billion, was the second-largest on record, despite the biggest fall in exports in a decade. Exports fell 2.8% from a year earlier but imports were down by 21.3%. A fall in **Britain's** exports led to a wider trade deficit in November.

Industrial production in the **euro area** fell by 1.6% in November. Following similarly large drops in the previous two months, this left it 7.7% below its level a year earlier.

Consumer-price inflation in **Sweden** fell sharply, from 2.5% to 0.9% in December, the lowest rate for almost three years.

Thailand's central bank reduced its benchmark interest rate from 2.75% to 2% on January 14th. This was the second big cut in as many months.

Output, prices and jobs

Jan 15th 2009
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2008†	2009†	latest	latest	year ago	2008†	rate‡, %
United States	+0.7 Q3	−0.5	+0.9	−1.2	−5.5 Nov	+1.1 Nov	+4.3	+3.7	7.2 Dec
Japan	−0.5 Q3	−1.8	nil	−1.4	−16.2 Nov	+1.0 Nov	+0.6	+1.5	3.9 Nov
China	+9.0 Q3	na	+9.1	+6.0	+5.4 Nov	+2.4 Nov	+6.9	+5.9	9.0 2008
Britain	+0.3 Q3	−2.0	+0.6	−1.7	−6.9 Nov	+4.1 Nov§	+2.1	+3.5	6.0 Oct††
Canada	+0.5 Q3	+1.3	+0.4	nil	−3.4 Oct	+2.0 Nov	+2.5	+2.2	6.6 Dec
Euro area	+0.6 Q3	−0.7	+0.7	−1.4	−7.7 Nov	+1.6 Dec	+3.1	+3.2	7.8 Nov
Austria	+1.5 Q3	+0.6	+1.6	−1.3	−2.7 Oct	+1.3 Dec	+3.6	+3.0	3.8 Nov
Belgium	+1.3 Q3	+0.4	+1.3	−0.7	−5.3 Oct	+2.6 Dec	+3.1	+4.4	10.8 Dec‡‡
France	+0.5 Q3	+0.5	+0.7	−1.0	−9.0 Nov	+1.0 Dec	+2.6	+3.0	7.9 Nov
Germany	+0.8 Q3	−2.1	+1.0	−1.4	−6.3 Nov	+1.1 Dec	+3.1	+2.6	7.6 Dec
Greece	+3.1 Q3	+2.0	+2.6	+1.4	−5.9 Nov	+2.0 Dec	+3.9	+4.4	7.4 Sep
Italy	−0.9 Q3	−2.1	−0.5	−1.2	−9.7 Dec	+2.2 Dec	+2.6	+3.4	6.7 Q3
Netherlands	+1.8 Q3	+0.1	+1.6	−0.6	−6.2 Nov	+1.9 Dec	+1.9	+2.3	3.8 Nov††
Spain	+0.9 Q3	−0.9	+1.0	−1.3	−17.2 Nov	+1.4 Dec	+4.2	+4.3	13.4 Nov
Czech Republic	+4.2 Q3	+3.8	+4.2	+0.8	−17.4 Nov	+3.6 Dec	+5.4	+6.5	6.0 Dec
Denmark	−1.2 Q3	−1.9	−0.4	−1.2	−6.8 Nov	+2.4 Dec	+2.3	+3.4	1.9 Nov
Hungary	+0.8 Q3	−0.3	+1.2	−1.5	−12.0 Nov	+3.5 Dec	+7.4	+6.3	7.8 Nov††
Norway	+0.6 Q3	−2.8	+1.8	−0.2	+0.1 Nov	+2.1 Dec	+2.8	+3.8	2.7 Oct***
Poland	+4.8 Q3	na	+5.1	+2.9	−8.9 Nov	+3.3 Dec	+4.0	+4.3	9.1 Nov‡‡
Russia	+6.2 Q3	na	+7.0	+3.7	−8.7 Nov	+13.3 Dec	+11.9	+14.1	6.6 Nov‡‡
Sweden	nil Q3	−0.4	+0.6	−0.6	−11.9 Nov	+0.9 Dec	+3.5	+3.4	6.2 Nov‡‡
Switzerland	+1.7 Q3	+0.1	+1.6	−0.6	+0.7 Q3	+0.7 Dec	+2.0	+2.4	2.8 Dec
Turkey	+0.5 Q3	na	+2.5	+1.5	−13.9 Nov	+10.1 Dec	+8.4	+10.6	10.3 Q3‡‡
Australia	+1.9 Q3	+0.3	+2.0	+0.8	+2.8 Q2	+5.0 Q3	+1.9	+4.4	4.5 Dec
Hong Kong	+1.7 Q3	−2.0	+3.1	−1.0	−6.7 Q3	+3.1 Nov	+3.4	+4.2	3.8 Nov††
India	+7.6 Q3	na	+6.2	+6.1	+2.4 Nov	+10.4 Nov	+5.5	+8.3	6.8 2008
Indonesia	+6.1 Q3	na	+6.1	+3.5	+7.0 Oct	+11.1 Dec	+4.9	+10.5	8.5 Feb
Malaysia	+4.7 Q3	na	+5.6	+3.2	−7.7 Nov	+5.7 Nov	+2.3	+5.8	3.1 Q3
Pakistan	+5.8 2008**	na	+6.0	+1.4	−2.2 Oct	+23.3 Dec	+8.8	+20.8	5.6 2007
Singapore	−2.6 Q4	−12.5	+2.2	−2.2	−7.5 Nov	+5.5 Nov	+4.2	+6.6	2.2 Q3
South Korea	+3.8 Q3	+2.1	+4.2	−1.7	−14.1 Nov	+4.1 Dec	+3.6	+5.0	3.3 Dec
Taiwan	−1.0 Q3	na	+2.3	−2.9	−28.4 Nov	+1.2 Dec	+3.3	+3.8	4.6 Nov
Thailand	+4.0 Q3	+2.3	+4.0	+1.9	−6.6 Nov	+0.4 Dec	+3.2	+5.8	1.1 Sep
Argentina	+6.2 Q3	+5.4	+6.2	+2.2	−7.2 Nov	+7.2 Dec	+8.5	+9.0	7.8 Q3‡‡
Brazil	+6.8 Q3	+7.4	+5.3	+2.4	−6.2 Nov	+5.9 Dec	+4.5	+5.8	7.6 Nov‡‡
Chile	+4.8 Q3	−0.2	+3.9	+1.0	−5.7 Nov	+7.1 Dec	+7.8	+8.9	7.5 Nov††‡‡
Colombia	+3.1 Q3	+2.9	+3.2	+2.0	−7.5 Oct	+7.7 Dec	+5.7	+7.1	10.1 Oct‡‡
Mexico	+1.6 Q3	+2.6	+1.8	−0.2	−2.7 Oct	+6.5 Dec	+3.8	+5.2	4.5 Nov‡‡
Venezuela	+4.6 Q3	na	+4.2	−3.0	+2.7 Sep	+30.9 Dec	+22.4	+30.5	7.2 Q3††
Egypt	+6.8 Q2	na	+7.2	+5.1	+6.8 Q2	+18.3 Dec	+6.9	+18.4	8.6 Q3‡‡
Israel	+5.1 Q3	+2.3	+4.2	+1.8	+1.8 Oct	+4.5 Nov	+2.8	+4.7	5.9 Q3
Saudi Arabia	+3.5 2007	na	+6.0	+3.0	na	+9.5 Nov	+4.8	+8.5	na
South Africa	+2.9 Q3	+0.2	+3.5	+2.5	−4.4 Nov	+11.8 Nov	+8.4	+11.4	23.2 Sep‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	−3.5 Q3	na	−2.0	−2.5	−17.7 Nov	+7.0 Dec	+9.6	+10.5	7.5 Oct
Finland	+1.3 Q3	+0.4	+1.6	−0.7	−10.1 Nov	+3.5 Dec	+2.6	+4.2	6.5 Nov
Iceland	−0.8 Q3	−5.5	−0.5	−9.7	+0.4 2007	+18.1 Dec	+5.9	+13.8	3.3 Nov‡‡
Ireland	+0.1 Q3	+4.7	−2.5	−2.9	+2.8 Nov	+2.5 Nov	+5.0	+4.2	7.8 Nov
Latvia	−4.6 Q3	na	−1.5	−7.0	−13.9 Nov	+10.5 Dec	+14.1	+15.7	7.2 Oct
Lithuania	+2.9 Q3	+1.6	+4.4	+1.6	na	+8.5 Dec	+8.1	+11.0	5.0 Nov‡‡
Luxembourg	+2.8 Q2	+4.5	+2.5	+1.5	−13.1 Oct	+2.0 Nov	+3.2	+4.0	4.7 Nov‡‡
New Zealand	−1.4 Q3	−2.7	+0.3	+1.1	+2.4 Q2	+5.1 Q3	+1.8	+4.3	4.2 Q3
Peru	+8.7 Oct	na	+9.1	+5.5	+3.6 Oct	+6.7 Dec	+3.9	+5.7	7.9 Nov‡‡
Philippines	+4.6 Q3	+3.4	+4.2	+1.8	+12.5 Sep	+8.0 Dec	+3.9	+9.6	6.8 Q4‡‡
Portugal	+0.6 Q3	−0.5	+0.4	−0.8	−3.0 Oct	+1.4 Nov	+2.8	+2.9	7.7 Q3‡‡
Slovakia	+7.0 Q3	na	+6.8	+3.3	−7.1 Nov	+4.4 Dec	+3.4	+4.6	7.8 Nov‡‡
Slovenia	+3.8 Q3	na	+4.2	+2.0	−12.0 Nov	+2.1 Dec	+5.6	+5.9	6.6 Oct‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions.- §RPI inflation rate 3.0% in Nov. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Jan 15th 2009
From The Economist print edition

The Economist commodity-price index

2000=100

	Jan 6th	Jan 13th*	% change on one month	% change on one year
Dollar index				
All items	167.4	157.0	+4.3	-32.2
Food	195.9	184.9	+3.8	-19.9
Industrials				
All	130.6	121.0	+5.4	-48.0
Nfa†	118.2	113.1	+8.9	-38.2
Metals	137.4	125.4	+3.8	-51.7
Sterling index				
All items	172.8	163.6	+9.6	-8.2
Euro index				
All items	115.7	110.2	+9.0	-23.5
Gold				
$ per oz	845.50	822.85	-1.6	-9.6
West Texas Intermediate				
$ per barrel	48.54	38.50	-12.7	-58.0

*Provisional †Non-food agriculturals.

US financial bail-outs

Jan 15th 2009
From The Economist print edition

By the end of 2008 the American government had committed $243.7 billion of public money to troubled financial institutions. The $40 billion used to buy shares in American International Group, an insurer, is the single largest injection of capital ever by a government. The rest has mostly gone to banks, which received $125 billion from the Treasury's Troubled Asset Recovery Program, or TARP, announced in October 2008. At the time, Citigroup, Wells Fargo and JPMorgan Chase secured the largest bail-outs, of $25 billion each, whereas Bank of America got $15 billion. Citigroup had to be rescued a second time, receiving a further $20 billion less than a month later. Other banks may soon also need more help.

Trade, exchange rates, budget balances and interest rates

Jan 15th 2009
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2008†	Currency units, per $ Jan 14th	Currency units, per $ year ago	Budget balance % of GDP 2008†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−833.1 Nov	−697.9 Q3	−4.5	–	–	−3.2	0.29	2.21
Japan	+47.3 Nov	+167.1 Nov	+3.8	88.8	107	−3.3	0.62	1.27
China	+295.1 Dec	+371.8 2007	+10.2	6.84	7.23	−0.1	1.48	2.75
Britain	−178.6 Nov	−45.6 Q3	−2.4	0.69	0.51	−5.3	2.23	3.37
Canada	+47.3 Nov	+19.2 Q3	+1.0	1.24	1.02	0.2	0.79	2.84
Euro area	−38.7 Oct	−61.5 Oct	−0.3	0.76	0.68	−1.6	2.65	2.94
Austria	−0.6 Oct	+16.8 Q3	+2.8	0.76	0.68	−1.0	2.57	3.82
Belgium	+7.9 Sep	−8.2 Sep	+0.1	0.76	0.68	−0.8	2.61	3.89
France	−83.3 Nov	−58.7 Nov	−1.8	0.76	0.68	−3.0	2.57	#REF!
Germany	+267.2 Nov	+244.3 Nov	+6.6	0.76	0.68	0.3	2.57	2.93
Greece	−68.5 Oct	−53.3 Oct	−10.3	0.76	0.68	−3.2	2.57	5.36
Italy	−17.8 Oct	−72.2 Oct	−2.9	0.76	0.68	−2.6	2.57	4.35
Netherlands	+55.4 Nov	+67.6 Q3	+6.7	0.76	0.68	1.1	2.57	3.58
Spain	−153.9 Sep	−165.8 Sep	−9.8	0.76	0.68	−3.3	2.57	3.93
Czech Republic	+4.8 Nov	−6.6 Nov	−2.9	20.6	17.8	−1.9	3.32	3.98
Denmark	+6.2 Nov	+6.3 Nov	+1.1	5.66	5.07	3.9	6.75	#REF!
Hungary	−0.1 Nov	−11.3 Q3	−5.0	212	174	−3.4	9.89	9.40
Norway	+78.9 Dec	+86.5 Q3	+18.4	7.21	5.42	19.7	3.47	3.67
Poland	−24.1 Oct	−28.1 Oct	−5.6	3.17	2.45	−1.8	5.65	5.13
Russia	+194.6 Oct	+98.9 Q4	+6.0	31.8	24.5	5.8	13.00	10.13
Sweden	+17.7 Nov	+40.5 Q3	+7.3	8.42	6.42	2.4	1.30	2.65
Switzerland	+18.2 Nov	+40.3 Q3	+9.1	1.12	1.10	0.9	0.57	2.02
Turkey	−72.7 Nov	−43.9 Nov	−6.4	1.62	1.18	−1.6	16.23	7.70‡
Australia	−5.0 Nov	−56.7 Q3	−4.8	1.51	1.14	−0.3	3.90	3.99
Hong Kong	−28.0 Nov	+27.1 Q3	+9.4	7.76	7.80	−3.9	0.80	1.30
India	−112.3 Nov	−28.5 Q3	−3.6	48.8	39.3	−4.3	4.69	6.76
Indonesia	+12.1 Nov	+3.9 Q3	+0.4	11,100	9,445	−1.4	11.11	10.10‡
Malaysia	+42.2 Nov	+38.3 Q3	+12.8	3.57	3.27	−5.0	3.37	4.10‡
Pakistan	−21.8 Dec	−14.0 Q2	−5.7	79.2	62.5	−6.8	15.16	23.01‡
Singapore	+19.7 Nov	+29.2 Q3	+16.6	1.49	1.43	0.8	0.77	1.85
South Korea	−14.2 Dec	−7.9 Nov	−2.2	1,348	940	1.1	3.16	4.34
Taiwan	+3.9 Dec	+28.8 Q3	+6.4	33.3	32.3	−1.6	1.15	1.42
Thailand	−1.3 Nov	−0.6 Nov	−1.0	34.9	33.1	−1.4	3.85	2.78
Argentina	+14.1 Nov	+9.0 Q3	+2.7	3.45	3.14	0.7	18.56	na
Brazil	+24.7 Dec	−26.3 Nov	−1.8	2.36	1.77	−1.5	13.66	6.16‡
Chile	+10.2 Dec	−1.6 Q3	−2.6	624	478	5.9	7.68	3.54‡
Colombia	+2.7 Oct	−5.3 Q3	−2.4	2,237	1,965	−1.0	9.73	7.19‡
Mexico	−14.5 Nov	−11.8 Q3	−1.7	14.1	11.0	nil	7.70	7.53
Venezuela	+50.2 Q3	+49.4 Q3	+15.5	5.37	5.40§	−1.1	17.65	6.55‡
Egypt	−25.2 Q3	+0.1 Q3	+0.8	5.53	5.46	−6.8	11.51	5.34‡
Israel	−13.7 Dec	+2.6 Q3	+1.3	3.91	3.73	−0.7	1.36	3.63
Saudi Arabia	+150.8 2007	+95.0 2007	+30.3	3.75	3.75	10.7	1.93	na
South Africa	−10.6 Nov	−23.2 Q3	−7.8	10.2	6.95	0.2	11.45	7.98
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−4.0 Oct	−2.7 Oct	−11.9	11.9	10.7	−1.0	7.43	na
Finland	+10.2 Nov	+6.8 Nov	+3.8	0.76	0.68	4.5	2.55	3.68
Iceland	−0.3 Dec	−5.4 Q3	−17.3	127	65.4	0.3	18.27	na
Ireland	+40.7 Oct	−16.4 Q3	−2.6	0.76	0.68	−6.5	2.57	4.56
Latvia	−6.1 Oct	−5.1 Oct	−14.2	0.54	0.48	−2.0	10.36	na
Lithuania	−7.3 Nov	−6.4 Nov	−13.9	2.62	2.35	−0.9	8.52	na
Luxembourg	−7.5 Oct	+4.0 Q3	na	0.76	0.68	0.3	2.57	na
New Zealand	−3.5 Nov	−11.6 Q3	−7.1	1.85	1.30	0.3	4.65	4.68
Peru	+4.0 Nov	−3.0 Q3	−2.8	3.15	2.94	2.7	6.50	na
Philippines	−8.7 Oct	+2.9 Sep	+1.8	47.1	40.8	−0.9	5.06	na
Portugal	−34.3 Oct	−29.3 Oct	−9.7	0.76	0.68	−2.4	2.57	4.11
Slovakia	−1.2 Nov	−6.7 Sep	−6.0	22.9	22.8	−2.3	1.35	4.12
Slovenia	−4.7 Nov	−3.4 Oct	−6.6	0.76	0.68	0.4	2.57	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

Markets

Jan 15th 2009
From The Economist print edition

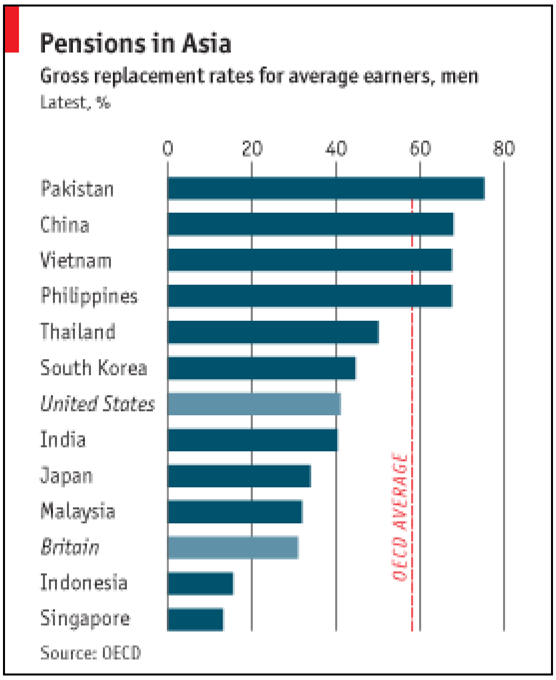
Markets

		% change on	Dec 31st 2007	
	Index Jan 14th	one week	in local currency	in $ terms
United States (DJIA)	8,200.1	−6.5	−38.2	−38.2
United States (S&P 500)	842.6	−7.1	−42.6	−42.6
United States (NAScomp)	1,489.6	−6.8	−43.8	−43.8
Japan (Nikkei 225)	8,438.5	−8.7	−44.9	−30.7
Japan (Topix)	819.4	−7.8	−44.5	−30.2
China (SSEA)	2,025.1	+0.2	−63.3	−60.8
China (SSEB, $ terms)	120.2	+1.9	−69.3	−67.2
Britain (FTSE 100)	4,180.6	−7.3	−35.3	−52.7
Canada (S&P TSX)	8,688.4	−4.7	−37.2	−50.1
Euro area (FTSE Euro 100)	701.3	−9.6	−49.0	−54.1
Euro area (DJ STOXX 50)	2,298.5	−9.5	−47.8	−53.0
Austria (ATX)	1,676.5	−11.7	−62.9	−66.6
Belgium (Bel 20)	1,890.3	−5.4	−54.2	−58.8
France (CAC 40)	3,052.0	−8.8	−45.6	−51.1
Germany (DAX)*	4,422.4	−10.4	−45.2	−50.6
Greece (Athex Comp)	1,743.5	−9.2	−66.3	−69.7
Italy (S&P/MIB)	18,763.0	−8.9	−51.3	−56.2
Netherlands (AEX)	247.3	−6.7	−52.0	−56.8
Spain (Madrid SE)	922.1	−9.3	−43.8	−49.4
Czech Republic (PX)	838.8	−4.6	−53.8	−59.1
Denmark (OMXCB)	232.3	−6.1	−48.2	−53.4
Hungary (BUX)	12,484.5	−3.8	−52.4	−61.2
Norway (OSEAX)	266.0	−6.8	−53.3	−64.9
Poland (WIG)	26,228.7	−8.0	−52.9	−63.4
Russia (RTS, $ terms)	591.3	−6.4	−66.6	−74.2
Sweden (Aff.Gen)	188.3	−9.9	−44.7	−57.5
Switzerland (SMI)	5,378.8	−6.6	−36.6	−35.8
Turkey (ISE)	25,055.7	−10.2	−54.9	−67.4
Australia (All Ord.)	3,624.3	−2.8	−43.6	−57.5
Hong Kong (Hang Seng)	13,704.6	−8.6	−50.7	−50.5
India (BSE)	9,370.5	−2.3	−53.8	−62.7
Indonesia (JSX)	1,386.9	−2.4	−49.5	−57.3
Malaysia (KLSE)	913.5	−1.5	−36.8	−41.5
Pakistan (KSE)	6,051.2	−0.4	−57.0	−66.5
Singapore (STI)	1,764.7	−6.2	−49.1	−51.0
South Korea (KOSPI)	1,182.7	−3.7	−37.7	−56.7
Taiwan (TWI)	4,521.5	−5.6	−46.8	−48.2
Thailand (SET)	439.5	−5.1	−48.8	−50.6
Argentina (MERV)	1,087.6	−6.8	−49.5	−53.9
Brazil (BVSP)	37,981.0	−7.0	−40.5	−55.3
Chile (IGPA)	11,671.5	−0.9	−17.1	−33.8
Colombia (IGBC)	7,610.8	−1.4	−28.8	−35.8
Mexico (IPC)	20,369.2	−7.9	−31.0	−46.7
Venezuela (IBC)	34,990.9	−0.6	−7.7	−59.0
Egypt (Case 30)	4,477.1	−5.0	−57.2	−57.3
Israel (TA-100)	584.6	−4.3	−49.4	−50.1
Saudi Arabia (Tadawul)	4,935.3	−7.3	−55.3	−55.3
South Africa (JSE AS)	20,843.0	−8.3	−28.0	−51.8
Europe (FTSEurofirst 300)	804.2	−8.4	−46.6	−51.9
World, dev'd (MSCI)	862.2	−8.2	−45.7	−45.7
Emerging markets (MSCI)	542.8	−8.8	−56.4	−56.4
World, all (MSCI)	213.8	−8.3	−47.0	−47.0
World bonds (Citigroup)	796.0	+0.3	+9.0	+9.0
EMBI+ (JPMorgan)	391.9	−1.4	−9.6	−9.6
Hedge funds (HFRX)‡	1,033.3	nil	−22.3	−22.3
Volatility, US (VIX)	49.1	43.4	22.5	(levels)
CDSs, Eur (iTRAXX)†	173.4	+5.5	+242.7	+208.5
CDSs, N Am (CDX)†	238.1	+10.2	+205.6	+205.6
Carbon trading (EU ETS) €	13.4	−13.6	−41.4	−47.2

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. ‡Dec 31st.

Pensions in Asia

Jan 15th 2009
From The Economist print edition



Some Asian countries have especially generous pension systems, judging by how much they pay in relation to average earnings. These "replacement rates" are considerably higher in Pakistan and China, for example, than the average for the mainly rich 30 OECD economies. This is one of several weaknesses in Asian retirement-income provision. In most countries the proportion of the workforce covered by mandatory pension plans is worryingly low. Early retirement, especially for women, exacerbates the financial strain on pension systems. Early action is needed to tackle these shortcomings, argues the OECD, since Asian populations will undergo rapid ageing over the next two decades.